

**CORPORATE GOVERNANCE REFORMS IN THE
PHILIPPINES:
AN ETHNOGRAPHIC APPROACH**

by

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CERTIFICATE OF AUTHORSHIP AND ORIGINALITY

I certify that the work in this thesis has not previously been submitted for a degree nor has it been submitted as part of requirements for a degree except as fully acknowledged within the text.

I also certify that the thesis has been written by me. Any help that I have received in my research work and the preparation of the thesis itself has been acknowledged. In addition, I certify that all information sources and literature used are indicated in the thesis.

Signature

DEDICATION

To the Philippines – may she rediscover her worth.

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ABSTRACT

This research investigates the impact of corporate governance reforms in Philippine institutions and firms. Literature reviewed looks at the macro and micro view of corporate governance theories and the prevailing business environment. The methodology of this research applies an ethnographic approach combining both deductive and inductive inquiries with a triangulated method using interviews, media articles and participant observation. Collection of the interview data occurred over four intensive months whilst in situ in Manila, Philippines. The data was then analysed using the NVivo qualitative analysis computer program.

The results of my data collection and analysis are explained and distilled in six chapters. They are:

- Chapter 4: Business and Corporate Governance Environment
- Chapter 5: The Regulators
- Chapter 6: Business Groups: The Owners of Companies
- Chapter 7: The Board and Management: The Controllers of the Company
- Chapter 8: The Government Financial Institutions
- Chapter 9: Corruption

The thesis concludes with a chapter on a summary of the research findings and recommendations for policy and practice.

CHAPTER 1: INTRODUCTION AND SUMMARY

This research is concerned with investigating the impact of corporate governance reforms in Philippine institutions and firms.

The Philippines is an island archipelago located in South East Asia with a population of 90 million people and a nominal gross national income per capita of USD1,890¹. In recorded history it was a colony for several centuries under Spain and then nearly half a century by the USA. In the period since the end of World War Two, it has suffered under various governments and one dictatorship under Ferdinand Marcos. The country continues to be destabilised politically and economically. It is currently a democracy-in-progress with the most recent presidential elections held in May 2010.

In investigating corporate governance reforms in the country, the context in which these reforms have been implemented must take into account the pre-existing business-economic condition: the Philippines is a developing country with underdeveloped institutions, a small private sector, a large public sector with a sometime predatory state.

The structure of this thesis is as follows:

Chapter 2: Literature Review

This chapter discusses the literature reviewed for this research and is divided into three main parts: the literature on introducing corporate governance, existing corporate governance theories of the firm, and the business environment.

Chapter 3: Methodology

This chapter discusses the qualitative method I applied in this research which is the ethnographic approach. Both inductive and deductive aspects of qualitative research were applied. Further, an account of the data collection is explained, while the use of the NVivo program for the data analysis is discussed.

¹ World Bank (2010) Philippine spreadsheet from World Development Indicators Database, April http://ddp-ext.worldbank.org/ext/ddpreports/ViewSharedReport?&CF=&REPORT_ID=9147&REQUEST_TYPE=VIEWADVANCED accessed 28 May 2010

Chapters 4-9: The Results

The results of my research findings are examined and explained in four chapters.

Chapter 4 discusses the business and corporate governance environment and Chapter 5 examines corporate governance regulators. Chapters 6 and 7 are the main corporate governance chapters that look at the private sector. Chapter 6 looks at the ownership factors, while Chapter 7 looks at the management factors. Chapter 8 provides an account of three government financial institutions and politicisation and the last result chapter, Chapter 9 on corruption, is the purely inductive result chapter of my research.

Chapter 10: Conclusions and Recommendations

The final chapter makes brief recommendations and the implications of my research for policy and practice. A summary of each chapter's contribution to knowledge and limitation of the research is also accounted for.

Appendices

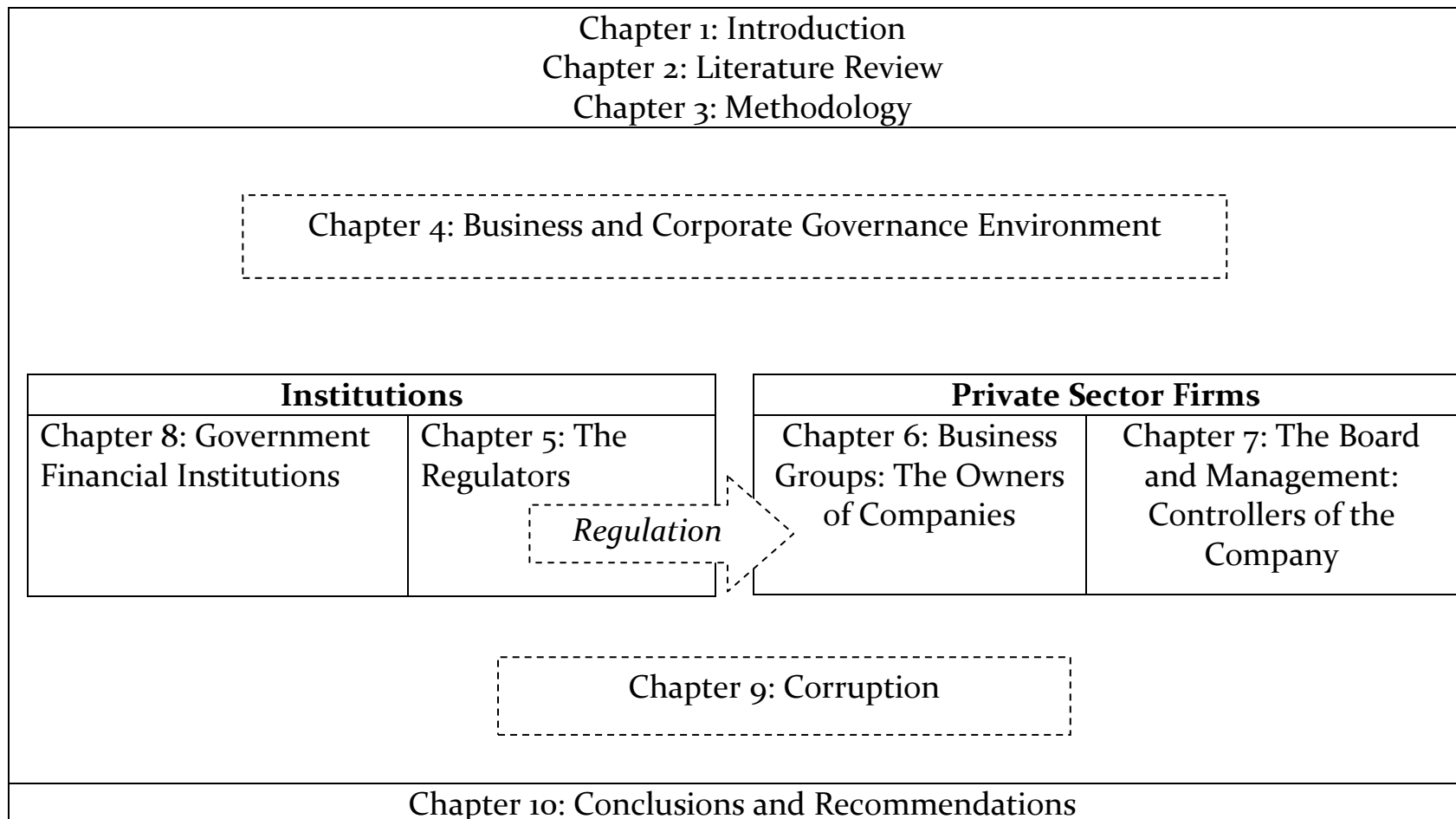
Supporting documents and data are included in the appendices. The appendices cover the research questionnaire, the list of organisations that participated in my research, the events and gatherings I attended whilst in the country, and the media articles collected. The structure of the thesis is summarised in the following table showing the elements of the research investigation, the applicable literature and the relevant chapter in the thesis:

Table 1: Summary of Thesis

Research investigation into corporate governance reforms in the Philippines		
Constituted elements of the research investigation	Applicable Literature	Relevant Chapter
Qualitative Ethnographic Approach	Ethnographic study, interviews, qualitative data analysis	Chapter 3: Methodology
Background to and introduction of reforms	Culture, Business and Political Environment Institutional Theory	Chapter 4: Business and Corporate Governance Environment
Impact on the regulators	Institutional theory	Chapter 5: The Regulators
Impact on the private sector	Business groups, family business research and corporate governance theories of the firm	Chapter 6: The Owners of the Company; Chapter 7: The Controllers of the Company
Impact on government owned financial institutions	Pension funds, politicisation	Chapter 8: Government Financial Institutions
Corruption	Predatory state, varieties of capitalism, developing economies	Chapter 9: Corruption

The research investigates corporate governance reforms in the Philippines. The constituted elements of this investigation include the method, the prevailing business and corporate government of the country, the background and introduction of the reforms, the impact on regulators, the private sector, and government owned financial institutions, and finally the impact of corruption on the country. A conceptual framework of the thesis is outlined in the following figure:

Figure 1: Structure of the Thesis and Conceptual Framework of Philippine Corporate Governance



Chapters 1-3 and 10 are the bookends of the results chapters. Chapters 4 and 9 relate the common business environment in the country. Government institutions and regulators are discussed in Chapters 8 and 5. Regulators in turn influence the corporate governance of private sector firms through regulation. The corporate governance of private sectors firms are looked at in Chapters 6 and 7.

This is the conceptual framework of the thesis and the chapters are organised around this to investigate the impact of corporate governance reforms in the Philippines.

CHAPTER 2: LITERATURE REVIEW

This chapter discusses the literature reviewed for this research. This review is divided into the following:

1. Literature on Introducing Reforms

This section defines, corporate governance, models, crises & reforms, politicisation, resource dependence, convergence theory and varieties of capitalism, and discusses institutional theory and the introduction of reforms through isomorphism. The literature in this section contributes to better understanding of results outlined in Chapters 4, 5 and 8.

2. Literature on Corporate Governance Theories of the Firm.

Corporate governance has two aspects: ownership and control. This section contributes to further understanding of theories of corporate governance and is divided into two parts:

- a) The micro-view of the firm or general corporate governance theories: agency theory (I and II), stakeholder, resource-based view, board relationships.
- b) The macro view of the firm and ownership in Asia: literature covered looks at the ownership of East Asian Corporations, family business research and business groups.

Literature in this section contributes to better understanding of results outlined in Chapters 6 and 7.

3. Literature on the General Business Environment

Literature covered in this section includes the economic sociology approach, culture, predatory state, crony capitalism and corruption. The literature in this section contributes to better understanding of results outlined in Chapters 4 to 9.

A framework of the literature covered in this research is outlined below and their relevance in the result chapters (Chapters 4-9) of this thesis:

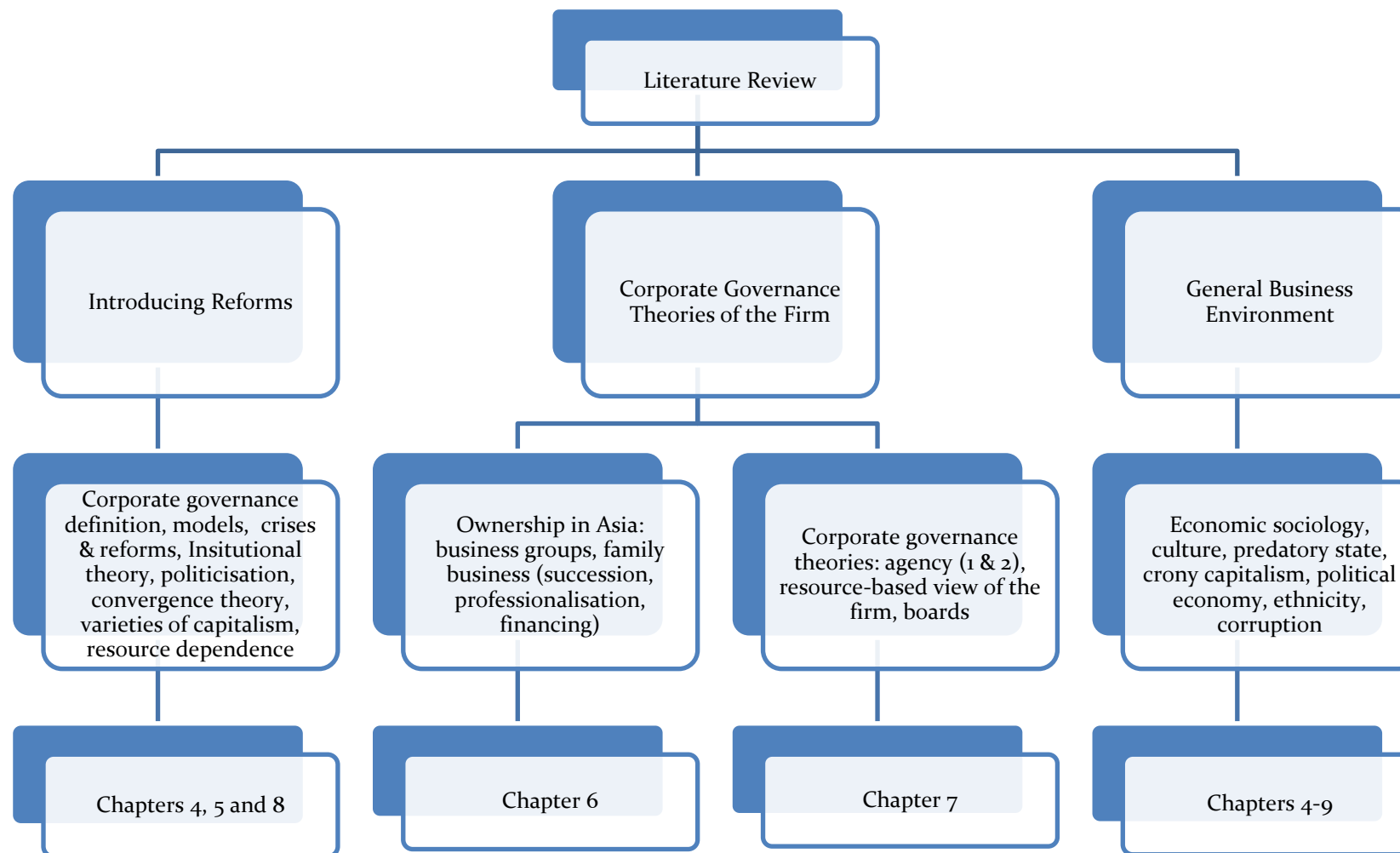


Figure 2: Structure of Chapter 2 Literature Review and Relevance to Results Chapters

2.1: Introducing Reforms

This section looks at a brief history of corporate governance reforms, institutional theory and politicisation and reforms in institutions.

2.1.1 Economic Sociology View of this Research

The approach of this research is based on the economic sociology view of the world. This research follows in the footsteps of Strachan's monograph on family-owned business groups in Nicaragua (1976), Sales' study of the merchant class or industrial bourgeoisie of Quebec (1979), Hutchcroft's research on the Philippine banking sector (1998) and Kang's comparative study on corruption and development between South Korea and the Philippines (2002).

The main focus of this particular research is on the impact of corporate governance reforms on private sector firms and government and regulatory institutions. Both institutional (regulatory) and organisational (private sector) views of corporate governance reforms are taken into consideration in this research.

As defined by Granovetter and Swedberg, this research assumes that economic action is a form of social action, that economic action is socially situated and that economic institutions are social institutions inhabited and directed by humans (1992:6 as cited by Morris & Manning 2005: 132). The field of this research is concerned at looking at the phenomenon of corporate governance reforms as it affects individuals, groups and institutions and the impact on their norms and values.

2.1.2 Defining Corporate Governance

In this research, the simplest definition of corporate governance comes from the 1992 Cadbury Committee into UK Corporate Governance which influenced corporate governance guidelines and principles worldwide:

“Corporate governance is the system by which companies are directed and controlled.” (Cadbury 1992)

An expanded definition of corporate governance comes from the Chair of the Committee, Sir Adrian Cadbury:

“Corporate governance is concerned with holding the balance between economic

and social goals, and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of these resources. The aim is to align as nearly as possible the interests of individuals, of corporations and of society...Resources will flow to companies which inspire trust, through their approach to governance and through the integrity of those who manage them...The incentive for the adoption of [internationally accepted governance standards] by nation-states is that these standards will strengthen their economies and encourage business probity.” (Cadbury in Claessens 2003: vii)

Therefore, corporate governance and its associated reforms are preoccupied with ensuring standards of behaviour of companies meet the expectations of society.

2.1.3 Current Preoccupation with Corporate Governance

The earliest notion of corporate governance can be found in the transnational and contractual relationships formed by the first multinational company, the Dutch East Indies Company (Frentrop 2003) while the foundation for the modern corporate governance movement was bolstered by the publication of Adolph Berle and Gardiner Means’ landmark book, *Modern Corporation and Private* which was a treatise on the impact of the separation of ownership and management control of the corporation.

Renewed interest in corporate governance and responsibilities of corporations began during the 1980s in the wake of the privatisation of government utilities, financial liberalisation, deregulation (Clarke & Pitelis 1993; Loredó & Suarez 2000) and corporate crises (Cadbury Report 1992). UK Thatcherite policies saw the transformation of ownership of formerly-owned government utilities , - once considered public goods – transferred to private owners. Concerns about the accountability, or lack thereof, in these former state-owned firms established an ongoing interest in their corporate governance framework. Subsequent corporate scandals in the UK saw the formation of the Cadbury Committee which produced the highly influential and template for corporate governance reform: the Cadbury Report.

Interest in corporate governance intensified in the wake of the East Asian crisis and the corporate scandals that engulfed the USA in 2001-2003 and Europe in 2001. The next three sections look at three geographical-based crises (East Asia, US, and Europe) which

highlighted the need and the paved the way for introducing and instituting good corporate governance to countries.

2.1.3.1 East Asian Crisis

For most of the 1990s, the East Asian growth was applauded by many commentators as a template for development (Amsden 1989, Gereffi & Wyman 1992, Kim, Y.C. 1995, Rohwer 1996). Foreign investment grew in the form of capital flows. Between 1965 and 1991, the annual growth rate of East Asia was 6.5%. In comparison the annual rate of other developing regions were 2% for South Asia, 1.8% for Latin America and 0.2% for Africa. The region's spectacular growth was described as a 'miracle' by the World Bank in an infamous 1993 report, *The East Asian Miracle: Economic Growth and Public Policy*. The region was seen as the emerging third economic power in the world after the USA and Europe.

In 1994, Paul Krugman, a Nobel Prize winning economist and a New York Times columnist, wrote *The Myth of Asia's Miracle*, published in Foreign Affairs magazine.² The article was a mix of political and strategic issues and while it dwelt on the rise of China, Krugman's paper was one of the first to question the foundations of the East Asian miracle.

The trigger of the East Asian was the currency devaluation of the Thai baht. As an Asian tiger, Thailand attracted foreign investment mostly to its manufacturing sector. The economy grew, and with it, a bubble ensued in the property and stock markets. Borrowings made in US dollars funded these markets. When the baht was devaluated; this triggered a meltdown in these two overheated and speculative markets. Currency speculators, the bane of any free market economy in crisis³, moved in and further devalued the baht (BBC 2002). With a floating currency, the Thai government let the currency fall further and investor confidence in the country was all but shattered.

Currency speculators moved on to the next Asian tiger and so the domino effect happened. In a matter of months, the economies of South Korea, Indonesia, the Philippines, Malaysia and Singapore experienced this onslaught to varying degrees. The

² A publication aimed at people in international banking and diplomacy circles.

³ Infamously, the financier and currency speculator, George Soros made a near-billion pound bet on the devaluation of the British pound which sparked Britain's own crisis and led to the fall of then PM John Major's government.

speculators hovered around the region as would a pack of wolves around an injured prey (Niederhoffer 1998). The crisis was a rude awakening for the region.

Debt exponentially grew as the currencies weakened against the US dollar. Hailed as the next Japan and then the world's 11th largest economy, South Korea was expected to weather this but was one of the countries most severely affected (Clifford 1997). The Philippine economy, on the other hand, lagged behind its immediate neighbours. In a region of tigers, the Philippines was East Asia's "stray cat" (Vos & Yap 1996). The country felt the flow-on effects of the rising tide of investor confidence in the early 1990s (Estanislao 1997) but did not feel the loss as keenly as other countries when the investor tide receded.

As an immediate measure, the International Monetary Fund (IMF) was charged with saving countries that faced bankruptcy, poured money into the region and bailed out Thailand, South Korea and Indonesia (IMF 1998, 1999). The last, Indonesia, was the country hit the hardest and the ensuing political upheaval ended the two decade long dictatorship of its president, Haji Mohammad Soeharto (Forrester & May 1998).

Post-crisis analyses are varied and many, ranging from the effects on the business environment (Backman 1999, Sheridan 1999), impact on global capitalism (Soros 1998), failure of international financial institutions (Stiglitz 2002), banking and financial systems (Cohen 1997, Delhaise 1998), regional implications (Lingle 1997, Gough 1998, Henderson 1998, McLeod & Garnaut 1998, Stiglitz & Yusuf 2001), and finally to post-crisis recovery (DFAT 1999, Segal & Goodman 2000).

On the firm level, the crisis "uncovered a vast number of inadequate corporate governance mechanisms, ranging from insufficient disclosure and transparency, poor supervision by the board, and weak regulatory and legal entities" while on the institutional level, "monopolistic market structures, overexposure to foreign exchange risks and over-leveraged domestic financial markets" (Arsalidou & Wang 2005: 330).

Weak legal institutions exacerbated the East Asian crisis. The countries worst affected by the crisis had inefficient judicial systems, weak or non-existent corporate governance systems, and non-transparent financial systems.

2.1.3.2 Enron and US Corporate Crisis of 2001-02

The poor corporate governance practices exposed in US corporations in late 2001 led to a national crisis of investor confidence (Clarke 2004a), an international crisis of confidence in corporations (Child 2002) and a philosophical crisis in market-based capitalism (Clarke 2004b). Confidence in corporate America imploded in a wave of false accounting (Enron and WorldCom), corporate looting (Adelphia, Tyco and WorldCom), fraud (Arthur Andersen), and inflated reports of stock performance (Citigroup, Merrill Lynch and Salomon Smith Barney). The US crisis of the early 2000s showed poor corporate governance practices were not an exclusive affliction of developing countries. The seismic effects of Enron and WorldCom's spectacular collapses questioned, amongst many other things, the reliability of America's corporate governance system and then-existing corporate and securities laws (Branson 2003). Such poor practices presented a "negative externality on the economy as a whole for any country." (Claessens 2003: 20).

The US reaction to these practices resulted in the Sarbanes-Oxley Act of 2002 (SOX)⁴ which emphasised prescriptive methods to encourage good corporate governance. However, the administrative issues, resulting paperwork and financial costs of compliance with the Act have made this law unpopular and forced some companies to treat corporate governance as compliance especially with the requirements of internal control disclosure (Branson 2006, Bainbridge 2006, Coates 2007, Romano 2005). This legislation also did not prevent the systemic collapse of the investment banking industry in the USA in the 2008 Global Financial Crisis (GFC), which exposed the fundamental deficiency of corporate legislation – that they are retrospective, reactive to failures, and do not prevent the events of greed and hubris that followed corporate America in 2008-2009. The main corporate collapses of Enron and WorldCom exposed the vulnerabilities of the internal risk processes of companies which SOX sought to address. In light of the GFC, the ambivalence towards SOX has been heightened and the question remains whether any future legislative measure can ever prevent further financial crises.

Nevertheless, the SOX Act has broadly impacted the corporate governance and disclosure practices of other countries. The international reaction to SOX was received with heightened awareness of the deficiencies in a country's corporate governance regime, but also of consternation and problems due to SOX's international influence and

⁴ Sarbanes-Oxley Act of 2002 <http://www.sec.gov/about/laws/soa2002.pdf> accessed 28 February 2010

reach. SOX directly affected foreign companies listed on the American stock exchanges and this brought some of them in direct conflict with their home-country's own company laws (UNCTAD 2003: 8-10). Nevertheless SOX has influenced many countries to rethink or establish their own corporate governance legislation.

2.1.3.3 Europe's Parmalat: The Collapse of a Family Business

Across the Atlantic, Europe's own Enron (Hooper & Milner 2003), the dairy corporation Parmalat of Italy, exposed the conflicts of interest that exist in a family-owned company in a globalised financial world:

“...former ‘family dictatorships’ have been forced to rely upon external capital (such as establishing long-term credit relations with a bank or by partially going public). In the case of family firms, the introduction of governance often means a radical transformation of traditional management practice...[resulting] in increased transparency...in accounting, reporting, and control procedures, as well as the disclosure of other, previously hidden kinds of information....[T]his has resulted in families becoming more and more compelled to share their control with other agents, such as institutional investors, financial institutions, and also minority stockholders, who can exert much more influence over leadership succession strategies than in the past.”(Colli 2003: 69-70)

In a different environment Parmalat's nepotism and opacity could have been adroitly resolved. However, the corporation's financial problems came on the heels of the corporate governance problems of Enron (2001) and the Dutch retailer, Ahold (2003). The financial markets were less forgiving when it was revealed that members of the Tanzi family, the founding family and owners of Parmalat, had been heavily involved in an elaborate €8B debt of a Chinese box which had the complicit agreement of the company's banks. Parmalat is a watershed for Italian business culture and for publicly listed family-run conglomerates (Della Sala 2004; DiStaso 2004, Melis 2005).

Also contributing to the crisis in European corporate governance were the practices of Dutch company Ahold with its accounting irregularities after bad acquisitions (De Jong et al 2005) and French Vivendi and the failure of its former emperor CEO Jean-Marie Messier to transform the former water utility to a global media giant (Johnson & Orange 2003).

The crises in the US and Europe showed how “the behaviour of the corporate sector affected entire economies” (Claessens 2003:1) while the financial crisis of East Asia and elsewhere “the deficiencies in corporate governance endangered the stability of the global financial system.” (Claessens 2003: 2).

2.1.3.4 Global Financial Crisis 2008-2009

The global financial crisis (GFC) of 2008-2009 was the most severe financial crisis since the Great Depression (Stiglitz 2010). In a way the three crises prior to this one were forerunners for the systemic failure that originated in the banking industry (Ward 2010). However, the outcomes from the regulation and reform from these three crises also did not prevent the GFC from happening. This shows the short-term memory and the imperfect nature of capital markets (Stiglitz 2010). The most immediate impact of the GFC is the shift in the balance of economic power from the USA where the crisis originated, to China, where its impact was minimal. (Stiglitz 2010) Similarly, governments intervened to nationalise and save some of their financial institutions thus re-introducing state-ownership to some sectors thus reversing decades of privatisation. Co-operation amongst the G-20 countries provided leadership out of the crisis and prevented a repeat of the Great Depression. However it is unclear whether the waves of post-crisis regulation can prevent another crisis on this scale (Johnson & Kwak 2010). The tension between the regulators (who want more regulation) and the regulated (who want less) mean piecemeal reforms will be the compromised result with the reluctant acceptance of the reality of the boom-bust cycle of global capitalism, and the realisation of whether avarice can ever be truly regulated.

2.1.4 Cycles of Crisis and Reform

This seeming cycle of crisis and reform was expounded theoretically by Clarke (2004b) that in the wake of crises, reforms and regulations comes into place – more in the hope that regulations would prevent the onset of another crisis. The following lengthy extract shows the essence of the corporate governance reform cycle:

“Corporate governance crisis and reform is essentially cyclical. Waves of corporate governance reform and increased regulation occur during periods of recession, corporate collapse and re-examination of the viability of regulatory systems. During long periods of expansion, active interest in the conformance aspects of governance diminishes, as companies and shareholders become again

more concerned with the generation of wealth, rather than in ensuring governance mechanisms are working appropriately for the retention of wealth, and its use for agreed purposes. This cyclical historical saga revolves around the enduring agency and stewardship dilemmas of governance. Complacency concerning corporate governance during confident times compounds ensuing crises. Such dilemmas are universal in market systems, though internationally with different systems of corporate governance the unwinding of this saga has occurred at different times, for different reasons, and with different consequences...The reason corporate governance standards and reforms will increase in future as a matter of public concern is that more of the public will have more of their wealth invested in companies they will insist should behave responsibly. The volatility of markets is part of the cycle of risk and return, and the significance of corporate governance is to mitigate the most damaging outcomes whilst encouraging the most positive.” (Clarke 2004: 153, 160-161)

The following perspective from UNCTAD notes the short-term memory of financial markets to remember the lessons from past mistakes:

“Recent corporate failures have served as the impetus for efforts to improve governance practices. They have demonstrated that no country, regardless of its size and market tradition, is immune from governance problems. However, there is the risk that once the current market and economic malaise wears off, the importance of governance will be forgotten, or if it is not forgotten, that governance projects will be slowed or put on hold until the next crisis forces a re-examination.” -UNCTAD (2003: 7)

Unfortunately, the waves of crisis and regulation show the short-term memory of markets and the cyclical nature of global capitalism.

2.1.5 Corporate Governance Models around the World

Corporate governance systems around the world reflect the different structures of ownership in a country or region (Clarke & dela Rama 2006). The path-dependency theory of corporate governance describes how the legal and institutional foundations of the home country are fundamental: “companies do not exist in isolation but are embedded in the social life of countries.” (Bebchuk & Roe 1999) Below are brief

summaries of the main features of the following corporate governance models around the world: Anglo-Saxon/Anglo-American, Germanic/Continental, Japanese, Latin and East Asian.

2.1.5.1 Anglo-Saxon or Anglo-American

The Anglo Saxon or Anglo American corporate governance model is defined by the ‘outsider model’ of widely dispersed shareholdings (Berle & Means 1933, Clarke 2004a, Ireland 2005). This model emphasises the separation of ownership and control of the firm. Managers are directly in control while owners (the shareholders) exercise control indirectly. Owners have little or no day-to-day control of the firm. The rise of executive or managerial compensation over the past 20 years is an issue. (Clarke 2007) In this model, the stock market reigns supreme. Boards are unitary with only a management board. Most boards have outside directors. In general, this model protects minority shareholders and emphasises shareholder value as the goal of the corporation with a short-term focus on wealth building (Clarke & dela Rama 2008). Countries that are categorised by this model are the USA and the UK. The former colonies of the UK such as Australia, Canada, New Zealand, and South Africa also fall under this model.

2.1.5.2 Germanic

In the Germanic model, there are usually two boards in a corporation – a supervisory board and a management board. The supervisory board is a stakeholder board with members from employee groups such as unions. It is an ‘insider’ model with banks playing an influential role (Rhodes & Van Apeldoorn 1998). Control is unidirectional. The stock market is less developed than the Anglo American model. This model has a long-term focus on wealth building. Countries falling under the sphere of the Germanic model include are Germany, Austria and Switzerland. (Clarke & Chanlat 2009, Fliaster & Marr 2006)

2.1.5.3 Japanese

The Japanese model is defined by an insider system of several companies being linked together and owning each other. Known as the *keiretsu* system, banks and institutions play an important ownership and strategic role in this model (Fliaster & Marr 2006). Boards are unitary and are dominated by managers, not directors. Minority shareholders receive little protection. This model emphasises stakeholder value and has a long-term focus on wealth-building (Clarke 2007).

2.1.5.4 Latin

In the Latin model, ownership is highly concentrated. Banks play an important role in the management of the firm (Rhodes & Van Apeldoorn 1998). Stock exchanges are relatively undeveloped. Minority shareholders are less protected and family firms dominate through holding companies. Countries such as France, Italy, Spain, Portugal and Brazil belong to this model. (Clarke & Chanlat 2009)

2.1.5.5 East Asian

The East Asian model is characterised by family control and high ownership concentration (Claessens, Djankov & Lang 2000). Control and ownership is not separated. Most large firms are family-owned, and are usually not listed or partially listed on the stock exchange. Stock exchanges are relatively new and underdeveloped. Control is through pyramid structures and cross-holdings. There is a long-term focus on wealth-building. In comparison to other models, firm and financial information is less publicly available. A small number of families control the economy and government officials directly participate in the control of the sector, suggesting the existence of crony capitalism. Countries belonging to this model include Hong Kong, Indonesia, Malaysia, Singapore, South Korea and Thailand. The Philippines definitively falls under this model.

2.1.6 Corporate Governance Reforms: OECD Principles of Corporate Governance

This section reviews the most influential principles of corporate governance and their impact. The Organisation for Economic Cooperation and Development (OECD) is a multilateral body representing the interests of its members: the developed countries of the world. A Business Sector Advisory Group in the OECD was set up in 1996, charged with setting up “minimum standards on corporate governance which should be followed by OECD countries.” (Dignam & Galanis 1999) Group members included corporate governance luminaries from the Anglo-sphere such as the UK’s Sir Adrian Cadbury and US lawyer-academic Ira Millstein. The members of this Group were “champions of the business lobby and charged with formulating behavioural norms for business in the international sphere.”⁵ (1999: 403)

⁵ The sentence continues: “No consideration is given to the public in their deliberations and the view of the corporation as a private actor with limited responsibility to the societies in which they operate dominates the recommendations of the Advisory group.”

By 1998, they were ready to deliver their standards. Coincidentally, the East Asian crisis was unravelling and so their deliberation gained importance as “the massive exit of global capital from the East Asian economies was a vote against corporate and financial malpractices in that region...[and] the Asian crisis may increase awareness of the dangers of an increased global economy and thus give initiatives designed to promote higher standards in that global economy more significance.” (Dignam & Galanis 1999: 396)

In 1999, the first issue of the Principles of Corporate Governance were published. A revised version appeared in 2004 to reflect more fully the changes that have occurred in the corporate governance landscape especially after the corporate crisis in America (OECD 1999, 2004).

These principles are the most influential standards of corporate governance and are based on the following six core notions:

1. Effective institutional and legal framework to support corporate governance
2. Corporate governance framework that protects and facilitates rights of shareholders
3. Equal treatment of all shareholders including minority and foreign investors
4. Importance of the role of stakeholders in corporate governance
5. Importance of timely, accurate and transparent disclosure mechanisms
6. Board structures, their responsibilities and procedures.⁶

The principles reflect “a global consensus regarding the critical importance of good corporate governance in contributing to the vitality and stability of our economies.” (Jesover & Kirkpatrick 2005: 127)

Fairness, transparency, accountability, disclosure and responsibility are the measures by which governance practice can be assessed. The initial set of principles was designed to be relevant for any organised entity be it private, public, state-owned or subject to other different forms of control and ownership. The principles also provide a benchmark for monitoring of corporations’ behaviour and resultant improvement and development by interested parties such as investors and regulators (Jesover & Kirkpatrick 2005: 172, Iu & Batten 2001: 48)

⁶http://www.oecd.org/faq/0,3433,en_2649_34813_31717413_1_1_1_1,00.html accessed 30 March 2010

While there are UN promulgations on behaviour of corporations such as the 1974 UN *Charter of Economic Rights and Duties of States*⁷ and 2003 UN *Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*⁸ that codify corporate responsibility, they are not binding and do not have monitoring mechanisms in place (Pryles et al 2004: 126). In the absence of an enforceable corporations' law that can be applied to any business entity worldwide, the OECD principles act as 'soft law' and are the default normative framework (Abbott & Snidal 2000, Branson 1999) The principles' influence can be seen in the reformulation of a country's corporate governance principles and unabashed reference on how the renewed principles adhere to, or are patterned after, the OECD principles.

In developed countries, most corporate governance principles are issued by stock exchanges and/or regulators closely following the elements outlined in the OECD document. The following extract from Australia's corporate regulator, the Australian Securities and Investments Commission (ASIC) shows how the OECD Principles are seen as best-practice:

“[The principles] have been widely adopted as a benchmark for achieving good corporate governance in OECD countries and elsewhere. The Principles are intended to assist OECD and non-OECD governments, such as Australia, in their efforts to evaluate and improve the regulatory framework for corporate governance, and to provide guidance and suggestions for stock exchanges, investors, corporations, and other parties that have a role in the process of developing good corporate governance.” (ASIC 2009)⁹

In developed countries, the principles act as “an *aide memoire* that emphasises and reinforces best practice”, while in developing countries, “the principles can act as a

⁷ <http://daccess-dds-ny.un.org/doc/RESOLUTION/GEN/NR0/738/83/IMG/NR073883.pdf?OpenElement> accessed 14 April 2010

⁸ <http://www.unhchr.ch/huridocda/huridoca.nsf/%28Symbol%29/E.CN.4.Sub.2.2003.12.Rev.2.En> accessed 14 April 2010; The major difference between the 1974 and the 2003 statement is the latter's specificity in stating the obligations of the humans responsible for a corporation: the managers, the members of corporate boards, directors, executives and employees. The 1974 Charter set the fields or boundaries of corporate behaviour (especially that of multinationals) in countries and their interference in a country's affairs, while the 2003 Norms have placed accountability at the feet of the principals of the corporation.

⁹ <http://www.asic.gov.au/asic/ASIC.NSF/byid/B285C74C43B87CBBCA256FDC00818039?opendocument> accessed 30 March 2010

blueprint for the establishment of a modern, outward-looking confident economy.” (Reid 2003: 237) The principles have been used extensively by the World Bank as a framework for policy dialogue to promote regional corporate governance reforms and roundtables in Asia, Latin America, Eurasia, South East Europe and Russia – that is non-OECD member countries.¹⁰ For example, an annual Asian Corporate Governance Roundtable has been held since 1999 of which the Asian Development Bank (ADB) is co-sponsor. The mandate behind the promotion of these principles to non-member OECD countries came from the G-7 with hopes that the roundtable would “improv[e] corporate governance in non-OECD member countries of the Asian region” while the participation of most Asian countries “confirm the adaptability of the [OECD] principles as a reference in varying legal, economic and cultural contexts.” (Jesover & Kirkpatrick 2005: 128).

Thus, the OECD Principles have been promoted with powerful institutional backing to countries around the world regardless of their economic situation, cultural and/or legal system.

2.1.6.1 Criticisms of the Principles

One of the earliest scholarly reflections on the principles was Dignam and Galanis’ 1999 article, entitled *Governing the World: The Development of the OECD’s Corporate Governance Principles*. According to the authors, there were two main motivations for the principles: preoccupation amongst developed nation-states about establishing a minimum set of corporate governance for their private sector, and concerns about the responsibilities of multinational corporations in overseas markets (1999: 396).

Thus, the principles provide a common set of standards for corporate behaviour that could be legitimised and applied to a company regardless of where they operated. The principles well-articulated the responsibilities of the board, however in other areas of societal interests such as employment relations, the principles did not “consider such issues in greater depth and to propose any possible solutions seem to suggest that employment insecurity is an irreversible condition and part of the acceptable costs of globalisation.” (Dignam & Galanis 1999).

Present criticisms of the principles are based on the following issues evoking the unintended consequences of ‘standardisation’ or harmonising towards externally

¹⁰ A list of corporate governance roundtables can be accessed through the OECD website: <http://www.oecd.org>

imposed standards:

1. The principles represent convergence towards the Anglo-American way of corporate governance and may be used as a tool to promote this way of reform regardless of its applicability or relevance. (Dignam & Galanis 1999, Iu & Batten 2001)
2. The Anglo-American way of corporate governance is culturally difficult to apply in countries which do not have the same legal tradition or economic situation and overlooks cultural nuances and present legal system of a country especially those not falling into 'common law' or Anglo-American legal sphere of influence (Branson 2001).
3. The principles alter countries' corporate governance systems to attract and suit foreign investors (Arsalidou & Wang 2005)

As a general corporate governance guide, the OECD Principles are seen as a way of linking investor confidence with good corporate governance. Good corporate governance practices bring in investors and adherence to the OECD Principles are a way to ensure such acceptable practices are maintained. The East Asian crisis exposed the defects of the corporate governance practices in the countries affected. The high growth rates achieved by the East Asian countries in a relatively short period of time exposed the institutional weaknesses of the countries - the institutions of the countries had not caught up with the needs of foreign investors. In Western countries, the development of corporate governance institutions occurred over a long period of time, and indeed most developed countries have not adopted such institutions. In most East Asian countries, corporate governance institutions are new, and in some cases, unformed (Grindle 2004, Chang 2005). Whereas crises in corporate America showed systemic problems within industries and regulatory oversight was insufficient due to regulatory capture, in East Asia, the 1997 crisis showed the regulatory institutions were wholly ineffective and were bypassed or didn't have the capability or resources to deal with the initial outflow of liquidity and its macroeconomic effects.

Chapter 4 of this thesis provides evidence on how the above criticisms were present in the introduction and implementation of the OECD Principles in the Philippines.

2.1.7 Convergence Theory and Varieties of Capitalism

The OECD Principles provide a useful example on how the theory of convergence works and the macroeconomic implications of their imposition within the varieties of capitalism debate.

Convergence is “the tendency of societies to grow more alike, to develop similarities in structures, processes and performances” (Kerr 1983: 3) through the application of imitative policies and development of economic systems. The OECD Principles are, arguably, an example of policy convergence i.e. moving towards formulating similar policies, in this case, in corporate governance. A more formidable example of policy convergence is the administrative consequences in the formation and consolidation of the European Union (EU) which led Unger to wonder whether policy convergence meant the end of policies (Unger 1997: 107). In countries where institutions have a long history and/or significant cultural value, policy changes are strongly resisted. Unger asks whether countries which do not adopt policies lose out in “international competition” as their performance cannot be measured by a particular standard. (1997: 107-108)

The wider implications of a set of policies across the globe is system convergence where there “is the growing together of whole societies from initial points of extreme, if not polar, difference: the developed and developing, the industrialised and industrialising, the democratic and totalitarian, the capitalist and socialist” (Unger 1997: 101). Arguably, the failure of the 2009 UN Climate Change Conference¹¹ where government leaders from nearly all nation-states on the planet met in Copenhagen, Denmark to come up with a commonly accepted climate agreement was one example of moves towards system convergence.

System convergence is linked to the varieties of capitalism debate. The varieties debate takes into account that the “key building blocks for the global economy are countries and firms.” (Gereffi 2005: 160). In this thesis both institutional and organisational perspectives of corporate governance reforms are studied.

After the downfall of communism, Michel Albert, a former French insurance executive, wrote in his insightful book, *Capitalism Against Capitalism*, that Western society, in

¹¹ UN Climate Change Conference, 7-19 December 2009
http://unfccc.int/meetings/cop_15/items/5257.php accessed 17 April 2010

general, was entering the third age of capitalism. The first age dealt with capitalism against the state (Albert identifies this with the French revolution and overthrow of the monarch in 1791), the second age was capitalism disciplined by the state (a century later in 1891 with the industrial revolution in full swing in Western Europe and the USA), the third age was a time of competing capitalisms (1991) where the form of capitalism with “jungles of dog-eat-dog competition and naked greed” have triumphed and consequently being imposed as fit and acceptable to industrialised nations (Albert 1993: 256).

Albert relayed the idea that countries with market economies faced the choice of two different types of capitalism: the Reagan-Thatcherite or Anglo-American model, and the non-Anglo model, here, the Rhenish or Franco-German model of capitalism. The latter model is also known as the relationship-based or network-oriented system (Moerland 1995; De Jong 1997). Latin-based countries, Japan, and mainly East Asian countries that followed the Japanese model, have tended to share some characteristics with this latter form (Gilson & Roe 1993, De Jong 1997, Barca et al. 1999, Li 2003). China’s form of economic development has been largely state-led whilst co-opting market mechanisms. The following figure summaries the varieties of capitalism debate as largely being dichotomous by either choosing the market-led (Anglo-American) or non-market led (non-Anglo-American) model of development:

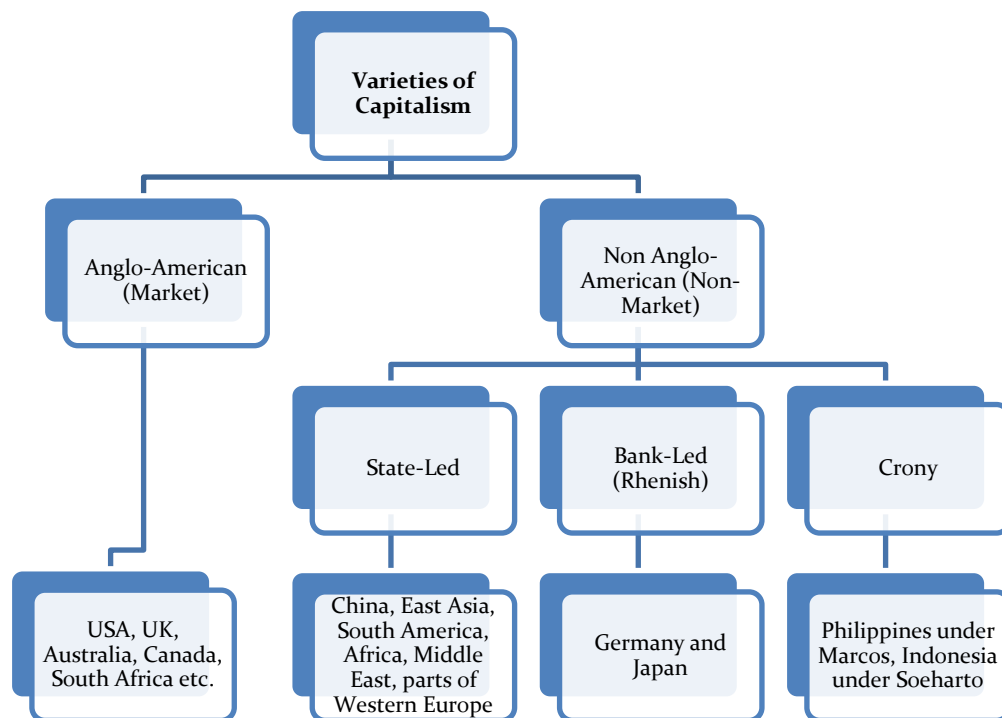


Figure 3: Different Varieties of Capitalism

The debate over which form of capitalism will triumph resonates in the arguments for (Useem 1998, Hansmann & Kraakman 2001, Coffee 2002), and against (Moerland 1995, Branson 2001, Engelen 2002 and Rhodes & Van Apeldoorn 1998) convergence of corporate governance towards the Anglo-American model. In corporate governance practice, the rise of a shareholder value culture in countries previously undisturbed by it have been documented by Lazonick & O'Sullivan (2000) and Engelen (2002). The rise of this culture has also seen the erosion of traditional management-labour employment practices (in Japan see Takeshi 2001, in Germany see Beyer & Hassel 2002 and Lane 2006) and the emphasis on excessive executive pay (Clarke & Chanlat 2009). These are seen as troublesome trends towards Anglo-American corporate governance.

For developing countries the implications of convergence theory go back the old adage of “who pays the piper calls the tune”. The OECD is a body set up by developed countries to represent and protect their interests. The widespread embrace of the OECD Principles by the development banks who are major funders of a developing country's program shows that convergence is happening on the policy level, though culturally and socially resisted on the ground. Countries most closely identifying with the Anglo-American model of capitalism have adapted relatively pain-free to the OECD Principles. For countries who do not, such as the Philippines, their adoption of the Principles have been challenging. (see Result Chapters 4-8)

2.1.7.1 Cross-Listings as a Sign of Convergence?

An issue central to the corporate governance convergence debate is the effect of cross-country multiple listings as standardising a singular, compliance-based form of corporate governance. Cross-listing describes the decision by a company to list in an overseas stock exchange so that it can access more capital than is accessible in its home country. Requirements of stock exchanges mean listed companies have to comply with the corporate governance standards of that particular stock exchange which directly affects the corporate governance structure of the listed company.

The impact of cross-listings on German companies was studied by Beyer & Hassel and they found companies were conforming “to Anglo-American corporate finance practices” (2002:312). An example of such a company is Daimler-Benz which listed on the New York Stock Exchange in 1993. After its takeover of Chrysler in 1998, the resultant transatlantic entity remained listed on the New York Stock Exchange (NYSE). Such a listing meant

complying with US securities laws, accounting and auditing standards, and other corporate governance hard and soft laws. In addition, the US listing served as a “credibility-enhancing mechanism” for Daimler (Coffee Jr 2002: 1793-94).

Davis & Marquis argue that compliance with stock exchange listing requirements is part of the cost for firms wishing to unlock the financial potential of their company in a market that appreciated their firm value. Therefore, any foreign company wishing to list on an American exchange are intentionally, willingly and tacitly change their corporate governance practices to suit the American financial and legal environment. The same applies in other exchanges, such as the listing by some New Zealand companies¹² on the Australian Stock Exchange in order to access a greater capital base than could be obtained by a sole listing in its home country. Thus, corporate governance convergence through cross-listings is also closely linked with the globalisation of stock markets. However, aside from standardising some financial elements in order to achieve the principal financial motivation, the Davis & Marquis study found most foreign companies listing on NYSE were not so willing to change their corporate governance practices. The structure of foreign firms was more likely to reflect the balance of power in their home countries and therefore “likely to be highly institutionalised and resistant to substantial change” (2005: 385). Thus, foreign firms attract higher prices than at home but remain unsullied by American corporate culture (2005: 384, 386).

Davis & Marquis’ study also cautions international financial institutions (IFIs) who engage in the transplantation of corporate governance practices but do not consider the institutional resistance to this imposition:

“With the right nudge from the IMF or other international advisors, nations might install American-style shareholder capitalism, with a realignment of other national institutions to follow. Yet if foreign firms that voluntarily list on the New York Stock Exchange continue to be imprinted by their home institutions, we have little reason to expect that those institutions themselves will easily shift directions.” (2005 386)

Therefore, the case against convergence in corporate governance is stronger despite the proliferation of cross-listings (Davis & Marquis 2005). The Davis and Marquis study

¹² Such as Telecom New Zealand, Air New Zealand, Burns Philp and others.

echoes the results of Guillen's (2004) survey of corporate governance convergence across countries.

In Guillen's study, the clearest indicator that corporate governance models were not converging is with the factor of a market (or lack thereof) for corporate control. While "the shareholder-centred model has historically been more susceptible to hostile takeover activity...[this] remains stagnant at relatively low levels [in developed countries while the] rest of the world remains largely unaffected by hostile takeovers" (2004: 235). According to Guillen the main cases against convergence are principally legal, institutional and political. These three factors alone "provide enough reason to cast serious doubt on the idea that there is convergence in corporate governance, whether on the shareholder-centred model or a hybrid" (2004: 239).

For companies in the Philippines that have listed on a foreign exchange such as NYSE, the stricter disclosure regime of the NYSE than the PSE has improved their processes but fundamentally, the ownership structure remains the same. The case of PLDT and the effect listing on the NYSE has had on the company's corporate governance practices are mentioned in Chapter 6.

Convergence theory and the varieties of capitalism debate provide useful perspectives on how elements of corporate governance are symptomatic of the top-down, policy-level harmonisation of global financialisation.

2.1.8 Institutional Theory

"Commerce and manufacturers can seldom flourish long in any state which does not enjoy a regular administration of justice, in which the people do not feel themselves secure in the possession of their property, in which the faith of contracts is not supported by law, and in which the authority of the state is not supposed to be regularly employed in enforcing the payment of debts from all those who are able to pay. Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government." -Adam Smith (1776) *Wealth of Nations*

Institutions are the outcome of human organising and interaction. They are normally indigenous structures that are the result of social, economic, historical, judicial, political and religious relationships. Institutionalists study the ways people have structured

organisations to have order in a society, have more efficient economic activity and also reduce transaction costs and production. Institutions are made up of both “informal constraints” and “formal rules” and are a reflection of socio-economic motives:

“Institutions provide the incentive structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation, or decline.”
(North 1991: 1)

In organisation studies, institutions are studied in a population of firms or organisations. Institutional theory looks at the *raison d'être* of an institution's existence and that they are essentially social constructs by fallible humans:

“Institutional theory reminds us that interests are institutionally defined and shaped. Institutional frameworks define the ends and shape the means by which interests are determined and pursued.” (Scott 1987:508)

Institutional theory also looks at the influence these institutions have on individuals or actors within, their influence on society beyond economic measures, and the reasons for their enduring persistence:

“Institutions, whether conceived as groups or practices, may be partly engineered, but they have a ‘natural’ dimension. They are products of interaction and adaptation; they become the receptacles of group idealism; they are less readily expendable.” (Selznick 1957: 21-22)

Some forty years later, Selznick reinforced the difference between the conception of the institution as an economic entity, and the institution as a social entity – the latter perspective providing the social relevance of the institutional theory:

“An institutional theory of the firm is a voice of resistance to this culture of short-sightedness, offers guides to thinking about corporate responsibility, and brings into question the goal of maximising profits or returns on capital. In this way, institutional theory speaks to issues of social concern and does so without accepting conventional models of organisation or the unreflective premises of management.” (Selznick 1999: 272)

Factors placing pressure on an institution's norms or practices come from three main sources: functional, political and social. Functional pressures seek to change the

organisational performance and practice of the institutions. Political pressures come about from the redistribution of power such as a change in government. Social pressures aim to alter current institutional practices to meet the public's expectations such as increased environmental awareness. (Dacin et al 2002). Legitimacy is also an important perspective on the credibility of institutions (Eisenhardt 1988: 492, Greening & Gray 1994: 470).

Accordingly, boundaries of institutions are set by "admixtures of regulative and governance arrangements; cultural-cognitive conceptions of identity and a sense of "being in the same boat"; normative and ethical frameworks that provide common rules and standards; and interdependencies borne of technical connections or dependence on similar types of material resources." (Dacin et al 2002: 51)

This can be seen on the supra-national level in the influence of international organisations such as the UN on governments; on the national level, the influence of governments or the executive on their ministries or private sector institutions.

Institutions can shape the structure of organisations within their circle through isomorphism. In DiMaggio and Powell's 1983 paper, *The Iron Cage Revisited*¹³ they defined a field of institutional theory where structures of institutions are shaped by isomorphism – a constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions. Their theory of institutional isomorphism helps "explain the observations that organisations are becoming more homogenous, and that elites often get their way, while at the same time enabling us to understand the irrationality, the frustration of power, and the lack of innovation that are so commonplace." (DiMaggio & Powell 1991: 95)

There are three mechanisms through which this change occurs:

1. *coercive* isomorphism stems from political influence and the problem of legitimacy (such as a government replacing a democratically elected one through force)

¹³ The iron cage refers to Max Weber's nightmare of the bureaucracy: "the iron cage...through which economic labour receives its present form and destiny...a system which inescapably rules the economy and through it the everyday destiny of man." Weber in Mitzman (2002: 260)

2. *mimetic* isomorphism resulting from standard responses to uncertainty (financial bubbles are an example of such mimicry, that is, “following the herd”)
3. *normative* isomorphism, associated with professionalisation. (DiMaggio & Powell 1983: 150)

Institutional isomorphism allows us to understand “how organisations conform to standards established by external institutions” and why “large organisations are more likely to be targets of institutional actors (e.g. regulatory bodies), and are more likely to provide the models imitated by other organisations. (Greening & Gray 1994: 470, 490)

In particular, Chapters 4 and 7 relate the impact of institutional isomorphism and its unintended consequences on organisations (and individuals) affected by corporate governance reforms.

2.1.8.1 Building Corporate Governance Institutions

While corporate governance institutions in Western countries are well-developed and entrenched (Roe 2008), the defects of East Asian regulatory institutions in light of the 1997 crisis provoked major capacity building efforts by multilateral development banks to address institutional weaknesses in developing countries. As Lazonick aptly put it:

“History shows, that the driving force of successful capitalist development is not the perfection of the market mechanism but the building of organisational capacities.” (1991: 8)

Similarly, the importance of the institutions of the law and regulation in studies of societies was also expounded by Edelman & Stryker (2005). Laws and enforcement thereof provide institutional legitimacy to the state but also certainty to society. Laws, regulations, government policies and official edicts oil the wheels of commerce by providing boundaries in the field. The absence of these tools is an obstacle to a well-functioning society as social norms are poor substitutes for legitimate social actions. Supporting the importance of the law in economic development also comes from La Porta et al’s 1998 study on *Law and Finance* which tracked the historical evolution of legal development across different jurisdictions.

On September 11 2001, the same date that prominent institutions in the USA were attacked, the World Bank’s Annual World Development Report (WDR) for 2002 was

launched entitled, *Building Institutions for Markets* (World Bank 2001). This report is a treatise on the importance of building institutions in developing markets divided into three parts, each focusing on the sectors of the economy with institutions: firms, government and society.

Building institutions for firms include institutions for farmers, corporate governance institutions and financial system development. Building institutions for government include political institutions, judicial reform efforts, promoting competition and regulating infrastructure. Building institutions for society include integrating informal and formal “norms and networks” institutions, and ensuring the independence of the media. The following table summarises the different issues for institutions in each sector:

Table 2: Institutions for Building Markets (World Bank 2001)

Firms	Government	Society
<ul style="list-style-type: none"> ▪ Secure and transferable rural land institutions; accessible rural financial institutions; institutions for agricultural technology and innovation ▪ Corporate governance institutions, laws and formal intermediaries ▪ Financial regulation for bank-based or market based financial systems, foreign investment, e-finance and financial services ▪ Business associations, rating agencies and foreign financial institutions 	<ul style="list-style-type: none"> ▪ Political institutions dealing with corruption and taxation ▪ Judicial systems over efficiency and cost; Judicial reforms over corruption ▪ Encouragement of domestic and international competition ▪ Designing and Regulation of infrastructure to deliver services to the poor 	<ul style="list-style-type: none"> ▪ Norms and networks; Building and adapting formal institutions, integrating informal and formal institutions ▪ Respect for the media’s independence, quality and reach ▪ Civil society organisations for freedom, transparency and anti-corruption

The importance of corporate governance institutions for firms or the private sector was articulated in this report. The report defines what corporate governance institutions and why they are necessary for a country’s economy:

“Corporate governance institutions are...the organisations and rules that affect expectations about the exercise of control of resources in firms. Well-functioning governance institutions allow entrepreneurs to invest resources and create value that is shared among the investors in a firm, the managers, and employees, as

well as with the entrepreneur/manager. These institutions therefore determine the expected returns to committing resources in firms. Where governance institutions are weak, the emergence and growth of firms are discouraged. Governance institutions include traditional corporate governance mechanisms, such as the board of directors and corporate and bankruptcy laws; product market institutions such as regulators responsible for competition; labour market institutions; capital market institutions, such as financial intermediaries; and the judiciary.” (2001: 55)

Corporate governance institutions encourage investment, enforce contracts, promote transparent and timely information, mitigate uncertainty and provide long-term benefits. Conversely, economic crises tend to intensify the weakness of a country’s corporate governance system: “weak governance in these firms has been associated with financial and economic crises, which can have severe consequences for poor people.” (2001: 73)

A criticism of the institutional-building efforts of the World Bank is its perspective that institutions are created solely to protect property rights (Bardhan 2005, Sindzingre 2005). Such “property rights reductionism” is problematic when “the relationship between property rights and economic development suffers from a number of conceptual, theoretical and empirical weaknesses.” (Chang 2005: 7). Chang argues property rights are “not something good in itself.” In practice, developing countries must choose which property rights to protect and under which conditions because it is impossible for them “to protect all existing property rights at all costs.” (2005: 11). While protection and recognition of property rights form the basis of Western law and commerce, property rights are more malleable especially in some developing countries where there is a high incidence of poverty and income inequality such as the Philippines.

According to Chang, institutions serve and promote economic development through their administrative function, learning and innovation, and income redistribution and social cohesion (2005: 3). Chang’s last point on income redistribution recognises some cultures that favour social cohesion and harmony over that of individuals and protection of property rights at any cost.

2.1.8.2 Institutions and Economic Development

A more substantial view of the role institutions play in economic development can be

found in Lin and Nugent's *Institutions and Economic Development* (2005). Lin and Nugent look at the reality and struggles of institutions in developing countries. More often than not, developing countries are politically unstable and institutions have to work around this instability. The text box below is my personal observation of an event that showed the importance of a working bureaucracy despite political turmoil.

Text Box 1: A Foreign Investment Forum

At a World Bank foreign investment roundtable, the head bureaucrats from India, Pakistan and six other South Asian nations were discussing ways to tackle the problems of corruption, rent-seeking, and politics that made bureaucracies inefficient, timely, costly and unresponsive to people's needs. As the conference was held during a period where tensions between India and Pakistan were high, the Pakistani delegate addressed the roundtable: "We all face similar problems. We know what they are. We know there are also many political problems that prevent us from instituting reforms. Despite wars, health epidemics, here we are sitting and sharing our experiences. Our politicians may disagree with each other but we have a job to do and we are all members of this region. Other sectors of the society may not function well, but we have to ensure our sector does." –personal observation

Institutions influence the pace and level of economic development, while economic development can trigger institutional changes (Lin & Nugent 1995: 2303) Institutions in economic development are divided into two types: market and non-market. Market institutions deal directly with contracts, commodity and factor markets. Usually, they are government institutions such as courts, securities commission, stock exchanges, and economic ministries. Non-market institutions are the firms and communities. Both market and non-market institutions complement each other due to their interconnectedness and interdependency with each other. (Lin & Nugent 1995: 2312)

Where there is underdevelopment, the most important institutions are "the family, the tribe and the kin group" (Lin & Nugent 1995: 2313). When rich countries undergo economic crises or economically regress, these familiar institutions are rediscovered because they are innate. In developing countries, strong family or kin ties are a safeguard for mutual survival, and insurance against hunger or starvation. (Lin & Nugent 1995: 2317)

In the absence of a strong welfare state, citizens rely on social welfare that may be provided by the company, but most importantly, by the family. This may explain why the family is at the centre of Philippine life. (See Chapter 4 on Culture)

Concurrently, when an individual achieves monopolistic political and economic power, the country's institutions suffer in the pursuit of self-interest:

“The weaker the linkage between the ruler's wealth and the growth of national income, the more likely a myopic wealth-maximising ruler bestowed with absolute personal power (e.g. Marcos in the Philippines) might be tempted to eschew property rights in favour of maximum surplus extraction. Rulers may be especially inclined to predatory taxation and other conditions unfavourable to economic growth when threatened.” (Lin & Nugent 1995: 2337)

Thus, institutional reforms in developing countries with absolute rulers are difficult to verify due to the power struggle that can exist between a president and the bureaucracy (Lin & Nugent 2005: 2338). Typically, the former usually prevails over the latter and a heavily politicised bureaucracy is the result.

2.1.9 Resource Dependence Theory

Similar to institutional theory, resource dependence theory also focuses on the external effects of political and institutional factors that impact the strategic practices of an organisation. Resource dependence theory deals with the “ecology of the organisation” and this perspective seeks to understand how these entities are managed and controlled as “[o]rganisations are inescapably bound up with the conditions of their environment.” (Pfeffer & Salancik 1978: 1)

The formation of business groups in the Philippine private sector as the best form of organising is best understood through the lens of the resource dependence perspective. The business group structure is a deliberate response to the external pressures of an organisation. The idea of organisational survival “to acquire and maintain resources” (1978: 2) has manifested itself with the conglomerate structure or group affiliation in order to withstand the political turmoil of the country and provide a bulwark against a predatory state. Chapter 6 looks at the relationship between business groups and the state.

For government and regulatory institutions, the resource dependence perspective highlights the sensitivity of these institutions to changes in the policy and administrative

fields. That is, government institutions are far more responsive to changes in the political field than the socio-economic environment:

“When organisations are regulated by the state, the economic environment diminishes in importance as the importance of the political and administrative environment increases. Both attention and behaviour shift accordingly. The decisions of consumers become less important than the decisions of lawmakers and government agents.” (Pfeffer & Salancik 1978: 203)

Chapters 4, 5 and 8 of this thesis analyse how government institutions in the Philippines - which do not follow the Westminster-style independent bureaucracy typically found in the UK or Australia - behave and respond to new policies and directives of their political masters.

Finally, Corbetta and Salvato (2004) contribute to the resource dependence perspective by looking at the role of the board in family-owned firms. The authors studied how a board's resources shapes the company's resources and contributes to its success (or failure). The board provides advice, knowledge, legitimacy, facilitates internal and external company communication and relationships:

“This resource role is played by board directors mainly through their social and professional networks and through interlocking directorates....The board of directors is hence seen as the place where conflicting interests are mediated, and where the necessary cohesion is created” (2004: 124)

Consensus-building is a fundamental feature of boards – a dysfunctional board rarely works and a conflicted board has a flow-on effect to the rest of the organisation.

Philippine boards are extensively discussed in Chapter 7.

2.1.10 Politicised Institutions

According to Kay, politicisation refers to “...the reaching of decisions on matters within an agency's or program's functional competence through a process that is essentially political and that does not reflect technical and scientific factors in the decision process; and ... the taking of specific actions on issues within an agency's or program's competence for the sole purpose of expressing a partisan [or self-interested] political

position rather than attempting to reach an objective determination of the issues.”

(1980:7 in Momani 2004: 900)

Politicisation of the bureaucracy in developing countries is a common, albeit problematic, phenomenon (Ilchman & Uphoff 1998: 30-48). Where a working bureaucracy exists, the institutions will have to work around the whims of the incumbent and vice versa. Such a scenario can end up in a catch-22 situation where institutional reforms cannot be initiated at all due to the fear and uncertainty changes might bring to the pre-existing power-political structure. (Lin & Nugent 2005: 2340)

The impact of a politicised bureaucracy results in the “primarily loss of confidence in the fairness of government institutions.” (Peters & Pierre 2004: 8) In the context of the Philippines, there is a history of politicisation in the civil service compounded under the tenure of Marcos. It has been rare for instances of impartiality to occur within the bureaucracy since the end of the dictatorship. In a study of the performance appraisal of the civil service in Singapore, Thailand and the Philippines, Vallance found the Philippine bureaucracy as highly politicised, fundamentally traumatised, and debilitated by a culture of patronage:

“Under Marcos, the distinction between politics and administration became increasingly blurred as the president appointed undersecretaries from the ranks of elected legislators. Patronage in the civil service became entrenched during the Marcos regime and notions of civil service neutrality were irreparably damaged. Despite President Aquino’s vow to ‘de-Marcosify’ the Philippine civil service (Carino 1989:214), the trend of politicisation has continued. Under President Ramos it is estimated that slightly more than half of all senior civil servants in the Philippines are political appointees (Santa Tomas 1995: 272 in Vallance 1999: 82).”

In a comprehensive 2003 report prepared by the World Bank and the ADB for the Government of the Philippines on improving the efficiency of government organisations, politicisation was singled out as a significant obstacle in the effective functioning of government. In a section on ‘Strengthening the Public Administration, and under the heading ‘Institutional Weakness’, the report articulated the main problems of a politicised bureaucracy in the Philippines: its function “too much as an adjunct of the political executive”, hierarchical culture, emphasis political influence and patronage, appointments based on patronage rather than merit, and poor salary compensation

making some sections prone to graft and corruption (World Bank and ADB 2003: 106-107). To be effective, institutional development requires political will, a relatively depoliticised bureaucracy, and a culture that is willing to be responsive and adapt to the changing needs of the country.

Politicisation of the Philippine bureaucracy hinders the country's performance and frustrates meaningful economic development. Chapter 8 of this thesis looks at the politicisation of government financial institutions.

2.2 Corporate Governance Theories of the Firm

This section looks at the general corporate governance (that is ownership and control) theories of the firm. There are many perspectives of corporate governance theories of the firm (Ho 2005) but this research focuses on three: agency, stakeholder and resource dependence/resource-based view.

2.2.1 Agency Theory

The use of agency theory to explain the phenomenon of corporate governance is well-established. It is widely cited and is adapted extensively across all social science disciplines. The application of agency theory is commonly represented in studies of corporate America where the research looks at the relationship between principal and agent – mainly the financial principals (such as shareholders represented by the board of directors), and the managerial agents (that of executives and managers).

The modern origins of principal vs. agent conflict can be found in the debates that occupied American legal scholars, Edwin Dodd, Adolph Berle and Gardiner Means in the aftermath of the 1929 Wall Street Crash. Berle and Means book, *Modern Corporation and Private Property*, was concerned with: “the growing concentration of economic power and increased dispersion of stock ownership made the public corporation in which a separation of ownership and control had taken place central to economic activity in the US.” (Clarke 2004a: 3). On the other hand, Dodd was occupied by the transformation of a business corporation into “an economic institution which has a social service as well as a profit making function [and] directors of large corporations must become trustees for an institution, rather than be mere attorneys for the stockholders they had to develop a sense of social responsibility towards employees, consumers and the general public.”

(Ireland 1996: 292) Today, Dodd's arguments can be seen as laying the foundations for the stakeholder movement.

In economics, Ronald Coase's treatise entitled¹⁴ *Nature of the Firm* (1937) focused on property rights and was the result of "the introduction of a new concept into economic analysis, transaction costs, and an explanation of why there are firms." (Coase 1991) Coase's ideas re-emerged in the 1970s, when several economists from UCLA Amren Alchian and Harold Demsetz and from the Chicago school Eugene Fama, Michael Jensen and William Meckling, expanded the arena of agency theory into their field with several influential papers on the theory of the firm (Alchian & Demsetz 1972, Demsetz 1983, Fama & Jensen 1983, Jensen & Meckling 1976). The theory of the firm observed that that firms are made up of a series of (individual) contracts between employer and employee, shareholder and manager, director and manager, and supplier and buyer:

Fama and Jensen's paper echoed Berle and Means 1933 book, which in turn influenced Claessens et al's 2000 paper on ownership and control in East Asian corporations. Alchian and Demsetz looked at ownership structure and structure of contracts (1972: 794), while Jensen and Meckling reviewed the contractual nature of the firm, the agency costs involved in undertaking a business and the limitations of a firm in society (1976: 311, 357). Inevitably, issues arise over the application of the contracts "when a) the desires or goods of the principal and agent conflict and b) it is difficult or expensive for the principal to verify what the agent is actually doing." (Eisenhardt 1989: 58)

In the organisational field, studies explored the reality of the principal-agent relationship in the boardroom. During the same period, Harvard Business School management professors Myles Mace (specialisation in entrepreneurship), Alfred Chandler Jr (business history), Jay Lorsch (organisational behaviour) with co-author Elizabeth MacIver, in a series of publications analysed the managers of "many large corporations who have dominant control over business affairs without sufficient accountability or monitor by their board of directors" (Alkhafaji 1989: 45). This was the era of the managerial hegemony of American corporations.

Mace (1971) provided a guide for directors on what to do, analysed "how triumphant

¹⁴ Coase was awarded the 1991 Nobel Prize in Economics "for his discovery and clarification of the significance of transaction costs and property rights for the institutional structure and functioning of the economy." Nobel Prize Committee, Press Release <http://nobelprize.org/economics/laureates/1991/press.html>

CEOs [selected and] controlled the board of the companies they ran” (Clarke 2004a: 8), and how directorships are “an accolade than an obligation – ornaments on a corporate Christmas tree” (Lorsch & MacIver 1989). In his 1977 book, *The Visible Hand: The Managerial Revolution in American Business*, Chandler describes how “a sub-species of economic man” - the manager - with the function of “administrative coordination and allocation...assumed command in the central sectors of the American economy.” This paved the way for the golden era of triumphant management which continues today. *Pawns or Potentates: The Reality of America’s Corporate Boards* published by Lorsch and MacIver in 1989 looked back at the research on directors and found “directors are less sanguine about their power and capacity to govern. While they don’t see themselves as pawns of management, they acknowledge a number of constraints [including] the superior power of management, particularly the CEO-Chairman.” (Lorsch & MacIver in Clarke 2004: 108)

In 1989, Kathleen Eisenhardt crystallised the relevancy and applicability of agency theory across a spectrum of social science research disciplines in a well-cited précis of the theory: *Agency Theory: An Assessment and Review*. According to Eisenhardt, “Agency theory provides a unique, realistic, and empirically testable perspective on problems of cooperative effort.” (1989: 72). However, she also points out the inherent limitations of the theory:

“Agency theory presents a partial view of the world that, although it is valid, also ignores a good bit of the complexity of organisations. Additional perspectives can help to capture the greater complexity.” (1989:71)

In trying to understand the ‘greater complexity’, the challenges in agency theory’s applicability has become more obvious with its widespread use in the past decade where concentration of ownership is a major factor in determining the separation of control in principal-agent relationships. Given major American listed corporations have widely-dispersed ownership and generally do not have a dominant owner-manager, this ownership composition does not hold in other parts of the world including the Philippines. A later section discusses concentration of ownership.

2.2.1.1 Limitations of Agency Theory in Developing Countries

In countries where family-owned and managed corporations dominate, the premise of agency theory in particular its costs, disappears as there is unity in strategic decisions:

“Clan control implies goal congruence between people, and therefore the reduced need to monitor behaviour or outcomes.” (Eisenhardt 1989: 64)

Nevertheless studies of corporate governance have expanded internationally, consequently broadening the theory’s scope and audience. Despite the sometime anomaly of agency theory’s application, there is persistence in its use in studies where ownership and control is one and the same (see Schulze et al 2001). This section looks at the application of agency theory in Asia and where family ownership is dominant.

Tsai et al (2006) applied an agency theory perspective to the CEO tenure of two different groups of Taiwanese firms: one family-owned, the other non-family-owned. They found that “the turnover of family CEOs is about half that of non-family CEOs; poorly performing family CEOs are more likely to be dismissed than non-family CEOs; family CEOs are more likely to enhance corporate value”(2006: 23-24, 26). The last result goes against the trend of studies that stated separation of ownership and control produced better corporate performance. They find that family control serves as the crucial monitoring factor that is generally absent in widely-dispersed ownership corporate forms:

“Agency theory is not applicable to family firms because self-interest and information asymmetry are not factors. Family control seems to serve as a monitoring system that substitutes for CEO bonding. We have shown that agency theory is applicable for non-family firms but unsuitable for family firms” (2006: 26).

Dharwadkar et al (2000) looked at the failure of privatisation in emerging economies from an agency theory perspective. The weak corporate governance structures within companies and lack of recognition of property rights in the external environment of most emerging economies resulted with an agency problem unique to developing economies - that of expropriation:

“Expropriation occurs within the weak governance context when large or majority owners assume control of the firm and deprive minority owners the right to appropriate returns on their investments. Thus, traditional agency problems of based upon principal-agent goal incongruence are supplanted by

unique agency problems arising from principal-principal goal incongruence.”
(2000: 660)

Young et al (2008) supports the principal-principal problem of owner vs. owner value expropriation to differentiate this from the traditional Western agency problem of owner vs. agent. Supporting this principal-principal conflict, Villalonga and Amit have described this as Agency Problem II to describe the awkwardness in agency theory's applicability in the situations documented above. Where Agency Problem I deals with the classic principal-agent problem of the despotic manager controlling the board, uncontrollable remuneration and ineffective monitoring popular in Anglo-American countries, Agency Problem II covers the asymmetrical relationship of the controlling shareholder, close monitoring and the issue of expropriation. (2006: 387)

Agency theory remains a powerful and influential theory to study corporate governance. However it is proving to be problematic to apply this theory in countries where firms have high ownership concentration. The practical limitations of the theory's applicability in non-Anglo-American countries such as the Philippines can be found in Chapter 7 of this thesis.

Researchers must appreciate ownership differences as a major factor in determining the usefulness of classical agency theory. Failure to acknowledge the differences underlying the suitability of agency theory may see the proverbial round peg being hammered into a square hole – that is, the popularity of the theory is such that one may overlook other corporate governance theories that are more relevant and applicable.

The other theories of corporate governance that follow may provide the perspectives that may capture the complexity inherent in the effective management of corporations in developing countries.

2.2.2 Stakeholder Theory

In contrast to agency theory, the stakeholder theory of the firm is inclusive, and the participants are not limited to the contracts and transactions between principal and agent. According to Clarke, the use of the term “stakeholding” can be traced back to 1708, which means to “have a stake in an event, a concern, to have something to gain or lose and to have an interest in” (2004a: 194). In modern parlance, stakeholders are the

“groups who have a direct interest in the survival of the organisation and without their support the organisation would cease to exist. This includes shareholders, management, board of directors, employees, major suppliers, major creditors, major consumers, and the government.” (Alkhafaji 1989: 36)

The stakeholder theory of the firm was first used by the Stanford Research Institute in 1963 “where stakeholder analysis was used in the corporate planning process by Igor Ansoff and Robert Stewart.” (Clarke 2004a: 194 and see also Freeman et al 2010: 30-32). Then, as now, contrasting opinions exist on what makes an individual or group a stakeholder of a company. The economist Milton Friedman took a severe view of stakeholders beyond financial ones:

“[F]or corporate officials to do anything other than to make as much for their stockholders as possible would not only be inefficient but constitute a fundamentally subversive doctrine capable of undermining the very foundations of our free society.” (Friedman in Ireland 1996: 296)

However, the corporation “solely as an economic enterprise is not feasible. It would virtually eliminate those stakeholder interests that are not profit-oriented” (Alkhafaji 1989: 106) and this links it with the path-dependency view of the corporation by Bebchuk & Roe’s on the social embeddedness of the corporation (1999). Blair cautions the shareholder value orientation of Anglo-American corporations at the expense of its obligations to society at large:

“To those who believe that corporations must serve some larger social purpose, governance reform proposals from the finance and market myopia camps might do damage to this larger social purpose if they tilt too strongly toward compelling corporate executives and their boards of directors to focus exclusively on maximising shareholder returns.” (Blair in Clarke 2004a: 174-175)

However, the notion of stakeholder capitalism which “encompasses reframing the relationship between finance and business; reforming workplace relations; transforming the welfare state and the benefit system; reformulating macroeconomic policy; and reconstructing the democratic system” (Clarke 1998) is unrealistic as a view of the corporation as “humane, social, truly democratic and equitable...is not socialist but utopian.” (Ireland 1996: 315)

Nevertheless, for the purpose of this research, a useful way of defining who is a stakeholder is by examining the various contractual and community relationships of a corporation. As outlined in the table below, contractual stakeholders are shareholders, employees, customers, distributors, suppliers and lenders. Community stakeholders are consumers, regulators, government, pressure groups, the media and local communities:

Table 3: Contractual and Community Stakeholders (Clarke 1998: 187)

Contractual stakeholders	Community stakeholders
Shareholders	Consumers
Employees	Regulators
Customers	Government
Distributors	Pressure Groups
Suppliers	The Media
Lenders	Local communities

In my research, I asked my interviewees their stakeholders. Some of them drew a distinction between their contractual stakeholder (financial) and community (non-financial) stakeholders supporting the dichotomy in Clarke’s table above (see Chapter 6, Stakeholders section).

The above table also clarifies the difference between the two theories of the firm. Where agency theory sees the firm as a series of contracts, stakeholder theory sees the firm as a series of relationships. (Clarke 1998)

Ultimately, companies can choose who its stakeholders are, and whose interests they want to serve. Known as the stakeholder enterprise strategy (Freeman & Gilbert 1988), one stakeholder group can be part of, or overlap with, another, and one stakeholder group’s interests can conflict with another. Stakeholder theory broadens our view of the corporation allowing us to see organisations as complex systems made up of competing groups.

In an influential paper on stakeholder theory, Donaldson and Preston (1995) examine the three types of stakeholder theory: descriptive or empirical, instrumental and normative. The descriptive or empirical describes and explains past, present and future states of corporate characteristics and behaviours (1995: 70). The instrumental type is used with the descriptive mode to identify connections or lack thereof, “between stakeholder management and the achievement of traditional corporate (financial) objectives such as

profitability and growth” (1995: 71). Finally, the normative stakeholder type identifies the “moral and philosophical guidelines for the operation and management of corporation” (1995: 71) reminiscent of the debates between Dodd and Berle on the corporation and its responsibilities. (Sommer Jr. 1991; Dodd 1932; Berle 1932)

As stakeholder and agency theories dominate conceptions of the firm, dual theoretical perspectives to corporate governance approaches are becoming common. Freeman and Evan state that it is “desirable to consider a framework for the firm as a series of multilateral contracts among stakeholders” (1990: 354). However, such an approach “would require a fundamental shift in managerial objectives away from shareowners and towards the interests of all stakeholders.” (Donaldson & Preston 1995: 80)

Agency theory’s narrow approach that simply examines the firm within the constraints of instrumental financial considerations is counterweighed by the broad church of stakeholder theory. As John Donne poetically wrote, no man is an island entire of itself. By the same token no corporation lives in splendid isolation.

2.2.2.1 Stakeholder Theory in Asia

Perhaps due to the embryonic corporate governance research in Asia, stakeholder relationships in Asia are neither well-studied nor well-understood as seen through Western eyes.

In Japan, incomplete information, and a hierarchical business culture that emphasises learning by monitoring compounds “the inability to write contracts for stakeholder relationships which expressly provide for all possible contingencies, because of the difficult of foreseeing future scenarios, and inability to perfectly enforce those contracts.”(Nottage 2001: 263).

David Lea (1999), in his study of the Bougainville separatist crisis in Papua New Guinea (PNG), relates the unrealistic expectations of “the imposition of further duties through legislation and moral pressure which arises in a third world context” in managing stakeholder relationships. According to Lea, the Anglo-Australian mining giant Rio Tinto provided a compensation package to villagers near its PNG Panguna copper mine. Despite establishing “trust funds for the people who were most affected by the mine...suspicion remained that the company was making vast amounts of money which should have been returned as benefits to the people of Bougainville” (1999: 158). Lea

argues “that when general imperfect duties to promote the public good are expected of business, it may become impossible for business to avoid disappointing certain people who will then perhaps unreasonably attribute ethical and moral failure to the corporation” (1999: 159). Lea further sees the use of stakeholder theory as a tool where “it can often be prescriptively uninformative and proscriptive redundant...[and] stakeholder theory may be used as an excuse for government to abdicate both its supervisory role and the responsibility for necessary collective goods.” (Lea 1999: 161-162)

The role of government in third world countries is a pivotal one. The absence of government cannot be filled by the private sector alone as the latter does not have the legitimacy and isn’t sufficiently capable - ideologically and operationally otherwise – to completely discharge its stakeholder responsibilities to fulfil wider community expectations. Functional government, rather than a functional private sector, is overwhelmingly far more important for a developing country than a dysfunctional government. Lea illustrates the consequences of delineated responsibilities in a third world country with a weak government and a strong corporation. This scenario resonated with some interviewees in my research (see Chapter 6).

In examining stakeholder theory in developing Asian countries, Darryl Reed employed the normative approach (2002). As there are deep-seated cultural, institutional, legal, managerial, ownership differences between Western and Asian economies, Reed suggests “supplemental normative principles” for corporations in these developing countries when applying stakeholder theory in Asia. The three principles are:

- a) the responsibility to respect acts of public autonomy (even when not legitimated through a formal democratic process)
- b) the responsibility to fulfil obligations not taken up by other actors (e.g. government)
- c) the responsibility to address problems of historic injustice. (2002: 184-185)

Reed notes further that a corporation’s responsibility in a country where there is a weak government are further magnified “on the grounds of morality” (they provide superior economic opportunities in terms of investment and employment) and “authenticity” (they portray themselves as socially responsible) (2002: 185-186).

There are pre-existing stakeholder relationships in the Philippines. Corporations in the

country by and large have engaged in stakeholder relationships especially given the wide gulf between the haves and have nots in the country – there is an inherent obligation on the former to contribute to the community and address issues of poverty. Programs of corporate social responsibility (CSR) are well established in the country such as providing infrastructure (work-sanctioned days off to build homes for the poor), and scholarships for students who are socio-economically disadvantaged.

The analogy of the Philippine corporation as an extended family takes a far more significant and socially embedded function in society. During my fieldwork, I was privy to the different ways of addressing the needs of an organisation's stakeholders. The relationship between an employer and employee in the Philippines is far more socially inclined. As religion is an important part of the society, companies have their own chapels and places of worship. In shopping malls, masses were conducted daily. Work stopped for the conduct of daily masses and prayers in-house at 9am, 12pm and 3pm. I was also made aware of social clubs within companies such as dance competitions, photography and art competitions. Chapter 7 examines stakeholder relationships in more detail.

2.2.2.2 Pension Funds as Important Stakeholders

A particular stakeholder of a corporation that is growing in importance is the pension fund (Davis & Steil 2001). A pension fund is no ordinary shareholder but a major institutional investor that may wield its influence and considerable shareholder power to promote a particular cause or issue as part of their fiduciary responsibilities (Hawley & Williams 2000). Indeed, pension funds worldwide are increasingly becoming important players and corporate governance reform activists¹⁵ (Palmieri 2002, Gillan & Starks 2000). In the case of government-originated pension funds, these institutions have been the result of government reforms aimed at outsourcing the financial and retirement needs of a country's ageing population. In countries with well-developed pension schemes, the portion of private sector participation in managing the superannuation and pension funds of citizens are substantial. (Davis & Steil 2001)

In the case of Australia, regulatory reforms in the 1980s saw mandatory participation for all working citizens and their employers to contribute a proportion of salaries to a superannuation fund. As a consequence of these reforms, a highly developed regime of

¹⁵"Pension funds over the years have grown substantially in size. Worldwide, the estimated total pension fund portfolio to around US\$12T of which US\$7T is from the USA" Palmieri (2002: 2).

retirement financial planning and numerous funds developed. These funds are active participants in the capital markets and their participation has contributed to the development and culture of the financial markets. The investments by institutional investors in public companies have dispersed share ownership to the wider populace: Over half of the population directly - and indirectly through their pension funds – own shares; rendering Australia with one of the highest share ownership rates in the world. (Stapledon 2001)

With greater participation in the capital markets, shareholder activism has grown on both the retail and institutional level with strong engagement with companies. The Future Fund is Australia's largest managed pension fund with assets of AU\$66B as at December 2009 (Future Fund 2010). The Fund was established to finance the pensions of government employees. It is government owned with an independent board. With financial globalisation, the Future Fund, similarly to other pension funds in the developed world are seeing their investment role move beyond national boundaries. The size of these funds is evolving to the stage where they are termed sovereign wealth funds with the ability to invest in other markets around the world and are the "major state-owned players of the 21st century" (Johnson 2007, The Economist 2008d). Such funds are taking advantage of opportunities brought on by the global financial crisis to invest in highly capitalised companies (and sometimes, countries) in distress.¹⁶ As institutional investors, the pension funds can significantly contribute towards shareholder democracy and capital market development. (Hawley & Williams 2000) In recognition of the role corporate governance plays in ensuring pension funds are as well governed as the firms they invest in, the OECD has released guidelines on pension fund management (OECD 2006b) and pension fund governance. (OECD 2009c)

However, countries in different stages of development have had different experiences in terms of autonomous decision-making towards investments by pension funds. The Philippines is a developing country with a developing capital market. Share market participation is small and exclusive. Nevertheless, the country has two significant institutional investors, the Government Service Insurance System (GSIS) and the Social Security System (SSS). Both are government-owned pension funds.

¹⁶ For a list of sovereign wealth funds that have played a rescuer/investor role in the wake of the 2008 global financial crisis, see the following Financial Times webpage: <http://www.ft.com/indepth/sovereignfunds> accessed 28 April 2010

These two funds cover approximately 74% of the labour force or 31% of the total population which places the country in a respectable position in the East Asian region as the following table indicates:

Table 4: Coverage Ratios of Pension Schemes (Ghosh 2006: 132)

Economy¹⁷	Active members ('000s)	Members as % of covered population	Members as % of labour force	Members as % of total population
Hong Kong	2,832	95.5	79.4	41.2
Indonesia	14,000	42.7	14.0	6.6
Malaysia	5,070	n/a	45.5	19.8
Philippines	8,925	n/a	74.0	31.0
Singapore	1,324	77.0	56.6	31.2
South Korea	17,070	n/a	73.0	37.1
Thailand	10,351	72.0	29.0	16.8

However, the next table below shows that compared to its neighbours, the assets of these two institutional investors ranked second last out of eight countries in 2006:

Table 5: Assets of Institutional Investors in East Asia (Ghosh 2006:130)

Economy	Pension		Life Insurance		Mutual Funds		Total	
	US\$ in B	% of GDP	US\$ in B	% of GDP	US\$ in B	% of GDP	US\$ in B	% of GDP
China	28.0	1.6	136.0	7.9	27.0	1.6	191.0	11.1
Hong Kong	38.0	22.9	9.0	5.4	465.6	280.3	512.6	308.6
Indonesia	5.4	2.1	10.5	4.2	11.1	4.5	27.0	10.9
Malaysia	70.0	59.2	21.0	17.8	23.0	19.4	114.0	96.4
Philippines	7.9	9.2	2.7	3.1	1.4	1.6	12.0	14.0
Singapore	68.0	61.2	33.0	29.7	28.0	25.2	129.0	116.0
South Korea	161.0	21.4	133.0	17.7	186.0	24.7	480.0	63.8
Thailand	20.0	12.0	17.0	10.2	19.0	11.4	56.0	33.6
TOTAL	398.2	11.8	362.2	10.8	761.0	22.6	1521.7	45.2

The country's pension funds are yet to match the financial leverage of its neighbouring countries and while: "[t]he assets of institutional investors in East Asia have grown over the past few years and at the end of 2004 amounted to USD1.5T or around 45% of GDP" (Ghosh 2006: 129), sitting on USD7.9B or nearly 10% of GDP, these two funds have some way to go to accumulate the significant institutional investor funds of South Korea

¹⁷ NB: For South Korea, National Pension Scheme only; Malaysia: Employees' Provident Fund Only; Philippines: GSIS and SSS only.

(USD161B), Malaysia (USD70B) and Singapore (USD68B): Chapter 8 discusses the organisation, structure, stakeholder role and corporate governance activism of these two funds.

2.2.3 Resource-Based View of the Firm

The resource based view of the firm has its origins in Edith Penrose's influential tome *The Theory of the Growth of the Firm* (1959, 2010), which posits the firm as a collection of productive resources (2010: 21-23, 58-77). In the 1980s, the rise of resource-based perspectives in strategic planning saw a more extensive exploration of this view of the firm. (Pitelis in Penrose 2010: xxxv; Wernerfelt 1984, Porter 1980, 1985)

The relevance of the resource-based view of the firm for business groups in developing countries was highlighted in Mauro Gillen's seminal work, *Business Groups in Emerging Economies: A Resource-Based View* (2000). The resource based view of business groups provides reasons for their affiliated firms to be widespread and dominate across a diversity of industries (2000: 368-369) and their advantages over foreign competitors (2000:376) due in large part to "asymmetric trade and investment conditions." (2000: 368)

However, unlike the institutional view of business groups the resource based view of the firm does not see business groups "as substitutes for markets that fail, but rather, as an organisational form in competition against foreign MNEs, and non-diversified firms lacking the capability to enter multiple industries." (2000: 376) That is, the resource based view gives business groups a superior advantage to others due to their conglomerate structure and allowing a sharing and cross-over of resources between companies within a business group. (See Table 7 for more detail on the theoretical perspectives of business group development).

However, this view of the business group as highly protectionist may overlook some of the historical reasons for their establishment, growth and persistence. The other side to the resource-based view of a business group in a developing country is where the internal resources of a firm interact with the external environment. Indeed, the resource-based view of the firm is closely related and complements the resource dependence theory perspective.

For Philippine business groups, the internal resource-based view of the firm poses the following question: how are resources administered (or protected) within a predatory state environment?

Under the dictatorship of President Ferdinand Marcos, there were moves by the President to expropriate businesses owned by conglomerates and transfer them to his cronies. Where majority ownership in a firm was below 50%, the firm was more prone to being taken over by the President's cronies. Seeing this move, the strategy by some of the family-owned business groups was to attract a foreign investor to take a minority interest in a business to offset the political risk of expropriation. The *raison d'être* being if Marcos expropriated the business, a foreign government would intervene and put pressure on Marcos not to expropriate the business. There was a belief that a foreign government would interfere to defend the ownership stake of the foreign shareholder.

Thus, cultivating relationships with foreign investors was one way to offset the bulwark of the state. This allowed business groups to diversify and apply its resources to ensure the survival of commercial operations during a period of instability. At the nadir of the Marcos dictatorship, for one business group, an owner's contacts in foreign governments that carried influence in the country were used to pressure the dictator not to expropriate that well-connected owner's company's assets. This was indicative of the fear and paranoia in the private sector. From this perspective, a business group used every possible resource to ensure the continued existence of the firm.

A resource-based view of the firm justifies the continued dominance of family business groups in unstable, developing economies - in effect, should a fickle government come into power with the view of expropriating company assets, the business groups are big and diversified enough to survive such a political move. This is one reason why the ownership strategy of business groups in developing countries such as the Philippines, is to ensure majority control is consistent and an explanation for their reluctance to relinquish majority ownership. In the Philippines, minority ownership makes a firm vulnerable to state-backed expropriation.

The relevance of the resource-based view of the firm in the Philippines is explored further in Chapters 6 and 9 where the private sector defensively behaved during the period of Marcos' dictatorship.

2.3 Boards

Theoretical literature on company boards distinguishes between exogenous issues (in the domain of agency, resource dependence and stakeholder theories) which look at how boards relate to its external shareholders, and endogenous issues which look at insider relationships within the board (Corbetta & Salvato 2004). Boards are “at the apex of the internal governance system, [are] responsible for corporate leadership and strategy, recruiting top management and monitoring managerial performance.” (Song and Windram 2004: 198) This section looks at the relevant board literature for my research with supporting data in Chapter 7.

2.3.1 The Chairman-CEO Relationship

The role and nature of the relationship between the CEO and Chairman is pivotal in the board. If the CEO and Chair roles are unified, this is commonly referred to as CEO duality and power is heavily concentrated:

“The power of the chairman added to the power of the chief executive presents a formidable combination.” (Cadbury 2002: 110)

CEO duality may lead to what Finkelstein and D’Aveni point out its double-edged sword: “forcing boards to choose between the contradictory objectives of unity of command and [CEO] entrenchment avoidance.” (1994: 1080)

Where the roles are separated, the Chairman must decide whether they are an executive or non-executive chair. For UK and Australian corporations, there is a requirement to explain why or why not the roles of Chair and CEO are united. The premise behind this is that concentration of power with a CEO that has both roles may prevent objective decision-making to the detriment of the company and may overburden the person with responsibility. As Cadbury points out:

“The separation of the two roles builds in a check and a balance. Chairmen are responsible for ensuring that their boards take account of the interests of the shareholders and that they carry out their supervisory functions conscientiously. Chairmen, who are also chief executives, have to be scrupulously clear in their own minds when they are acting as the one and when as the other, as they move between the two roles. It can be done and it is done, but it is less demanding on

all concerned to divide the roles rather than the individual. When someone who holds both positions is determined on a course of action, which perhaps entails high risks for the company, who is to challenge their judgement?" (2002: 110)

For Philippine corporations, the roles are normally combined. Or if they are separated, then the two individuals come from the same ownership interests or from the same business family typically with a father-son combination. This duality is a reflection of the business being an extension of the family with the family's "identity or reputation" intricately linked to the business. (Gersick et al 1997: 37)

2.3.2 Board Composition and Independent Directors

A board is normally composed of the corporate elite with a combination of executive (employee of the firm) and non-executive (non-employee of the firm) directors. The introduction of outside independent directors into Philippine boards was nominally the introduction of this distinct Anglo-American form of corporate governance.

The presence of outside directors on a board gives non-controlling shareholders a voice in that they provide the monitoring mechanism inside the board. In Anglo-American corporations, outside directors have been found to be "more vigilant than directors with other firm affiliations because:

- 1) They focus on financial performance which is a central component of monitoring
- 2) They are more likely than insiders to dismiss CEOs following poor performance, and
- 3) Protecting their personal reputations as directors gives them an incentive to monitor." (Finkelstein & D'Aveni 1994: 1081-1082)

However, for non-Anglo American corporations, outside directors on family-owned businesses may not be as welcomed. Lansberg & Perrow's study of Latin American companies showed that the personalistic and insider business culture made business families paranoid about the presence of outsiders on their board raising issues of "confidentiality and security." (1991: 143). Results in Chapter 7 support attitudes displayed in Lansberg & Perrow's research.

2.3.3 Board Committees

Boards are also composed of board committees which are powerful groups in their own

right. These committees “lead to greater efficiency, expediency and flexibility” with their use allowing “greater input from and objectivity among members.” (Kesner 1988: 67) Each board committee “contributes in a specific way to the overall governance framework of the board of directors.” (Bilimoria and Piderit: 1994: 336)

In an American study, Kesner identified the four most common, influential and powerful board committees in a company were the audit, nomination, compensation (or remuneration) and executive committees. (1988:87) In the Australian corporate environment, the most frequently cited committees were audit, remuneration, nomination and risk management. (CCG 2007: 42)

2.3.3.1 Audit Committee

The audit committee is the most important board committee as it oversees the “adequate functioning of internal control mechanisms, monitoring and focusing on reviewing financial risk and risk management. The audit committee helps determine indicators of problems and address these problems, mitigate possible damage and enhance shareholder value.” (Haron et al 2005: 118). It has been aptly described as the “workhorse of corporate governance.”(Miller 1999, Grace & Hauptert 2006: 63)

The audit committee is nominally the first committee established on the board, is the most active, and is a critical function in how the internal and external relationships of the board are engaged and conducted with the board’s stakeholders. (Song & Windram 2004: 196) Audit committees are generally expected to discuss matters relating to “financial statements and reporting, audit planning, internal control and evaluation” and are expected to focus on “compliance with standards and regulatory bodies, probing material items and undisclosed liabilities.” (Al-Mudhaki and Joshi 2004: 33).

The audit committee is a crucial corporate governance function and financial market regulators emphasise its importance in company operations and require their establishment (Goodwin 2003: 65). The audit committee is the principal gatekeeper to “safeguard integrity in financial reporting.”(ASX 2007: 11).

In Anglo-American corporate governance, it is common to have independent directors wholly comprising and chairing this all-important committee. (ASX 2007: 11, UK FRC 2008: 17). Empirical researches have also found that financially-literate (Al-Mudhaki & Joshi 2004: 33) independent directors are seen as best improving the effectiveness of this

committee. (Song & Windram 2004: 203, Beasley 1996: 458, 463)

2.3.3.1.1 Internal and External Auditors

Helping the audit committee in properly discharging its duties is the role of the internal auditor (Bishop III et al 2000: 50, 51). The internal auditor is integral to the internal control system of a company (Carcello et al 2005: 119). An independent audit committee with members cognisant of the latest financial accounting standards complement and supports the role of the internal auditor (Goodwin 2003: 264). Leadership from the audit committee is pivotal in supporting the internal audit function. (Zin & Subramaniam 2007: 894).

The integrity of financial statements is crucial in the operations of a company. If the language of business – that is, the numbers – cannot be trusted, then what can be? The external audit function plays a pivotal role in sustaining this paradigm. The institutional recognition of having an external auditor sign off a company's financial statements completes the verification process. (Power 1997, Holm & Laursen 2007) However, this verification process has also its downside and may undermine the efficacy of financial statements. Generally, if external auditors accept the information given to them by the owner, and this information is verified even if the data is false, the blame can be shifted to the auditors if corporate malfeasance is eventually uncovered.

2.3.3.1.2 Auditor Rotation

Auditor rotation is gaining currency to mitigate auditing-related risks such as auditor-capture. The practice of mandatory auditor rotation was motivated by a 2003 study from the US General Accounting Office (GAO). This study was in response to public concerns after the spectacular collapse of Enron and the complicity and multiple conflicts of interest it had with its auditors, Andersen (US GAO 2003: 8). The 2003 study was inconclusive and ambivalent on the effectiveness of auditor rotation to improve the integrity of financial statements. (2003: 13) In this regard the debate on the effectiveness of auditor rotation has more to do with perception and rotation in theory is supposed to diminish the conflicts of interest between external auditor and company. This practice seems to have gained currency and some institutional backing despite insufficient evidence for the practice (Kaplan & Mauldin 2008)

2.3.3.2 Risk Management Committee

A risk management committee is normally formed to exercise the board's oversight function in managing "uncertainties about events and/or their outcomes that could have a material effect on the goals of the organisation." (Subramaniam et al 2009: 319)

These uncertainties can include internal company risks such as those relating to the operational performance and financing of the company. External risks relate to the organisation's relationships with its stakeholders, such as those pertaining to the supply chain, industry regulation and managing political risks with governmental organisations. (Remo 2007, Economist 2008, EIU 2008)

A risk management committee determines and evaluates the risk management strategies and operations of a company, assesses its financial reporting and ensures compliance with existing laws and regulations. Members of the risk management committee are expected to discuss the functions and a company's approach towards risk with senior management, and ensure the adequacy of risk mitigation procedures. (Subramaniam et al 2009:320)

2.3.3.3 Nominations Committee

As the name suggests, the nominations committee is tasked with identifying potential candidates for a board directorship. Research on nominations committee have been neglected in favour of the audit committee as the committee is seen as an adjunct to other committees. However, it plays an important role in determining diversity and composition of the board (Ruigrok et al 2006). For Philippine corporations, it has become a pivotal board committee in determining and short-listing independent directors (see results in Chapter 7).

2.3.3.4 Executive Committee

An executive committee generally consists of senior managers of the company. The committee is tasked with "internal agenda setting and strategic governance in times of crisis. For the effective performance of these functions, members are called on to be extremely familiar with the internal functioning of the company." (Bilimoria and Piderit 1994: 349) In case of emergencies, the committee also serves "as a stand-in to act in lieu of a full board when immediate actions are needed" and therefore plays the role of the board "in counselling the CEO on ideas...and overseeing other board committees." (Kesner 1988: 83) Companies in the Philippines generally have a powerful executive

committee as the CEO (as manager and owner) sit on this committee (for more detail see Chapter 7).

2.4 Business Groups

This section looks at concentration of ownership in East Asia and in particular the corporate form of family-owned business groups in the Philippines.

2.4.1 Concentration of Ownership

In developing countries, ownership is highly concentrated. Ownership concentration is a manifestation of economic control (see Berle & Means 1933, Sales 1979 for classifications of control). In the ground-breaking study by Claessens, Djankov and Lang (2000) of 2,980 East Asian listed corporations, they found more than two-thirds of firms are controlled by a single shareholder. In the Philippines, the top 15 families control 55% of corporate assets, and 46% of the GDP. The table below shows the percentage of concentrated ownership across the region ranging from Japan where only the top 15 families control 2.1% of that country's GDP to Hong Kong where the top 15 families control over four-fifths of that island state's wealth:

Table 6: Concentration of Family Control in East Asian Corporations (Claessens et al 2000: 108)

Country	Average No. of Firms per Family	% of total value of listed corporate assets that families control (1996)				% of GDP
		Top 1 family	Top 5 families	Top 10 families	Top 15 families	
Hong Kong	2.36	6.5	26.2	32.1	34.4	84.2
Indonesia	4.09	16.6	40.7	57.7	61.7	21.5
Japan	1.04	0.5	1.8	2.4	2.8	2.1
Korea	2.07	11.4	29.7	36.8	38.4	12.9
Malaysia	1.97	7.4	17.3	24.8	28.3	76.2
Philippines	2.68	17.1	42.8	52.5	55.1	46.7
Singapore	1.26	6.4	19.5	26.6	29.9	48.3
Taiwan	1.17	4.0	14.5	18.4	20.1	17.0
Thailand	1.68	9.4	32.2	46.2	53.3	39.3

According to the 2002 World Development Report, there is a link between high concentrated corporate ownership and the efficacy of legal protection in countries. That is, "concentrated ownership tends to substitute for weak legal protections" (2001:58).

This view complements and supports resource dependence theory and the resource based view of the firm in developing countries: where there is an unstable political environment, the conglomerate form is the preferred method of organising. Investors in weak institutional environments also play a premium on firms who are part of conglomerates due to the perception that “concentrated ownership delivers great benefits when those owners in control have appropriate incentives and when owners outside the firm have more leverage” (World Bank 2001: 58).

The other side to this is that the treatment of minority shareholders is a pressing corporate governance issue in countries with concentrated ownership (see also Agency Theory in this Chapter). Even where the prevalence of business groups is a private response to weak government institutions, the concentration of wealth in a few people, families or groups is a “formidable barrier to policy reform” and could negatively affect “the evolution of the legal and other institutional frameworks for corporate governance and the manner in which economic activity is conducted.” (Claessens et al 2000: 110). Chapter 6 of this thesis looks at the evidence of having concentrated forms of ownership in the Philippines as a response to an unstable environment.

Concentration of ownership in the private sector of the Philippines and most of East Asia is manifested in the widespread corporate form of business groups. Granovetter’s definition of business groups is applied here:

“One can consider as business groups those collections of firms bound together in some formal and/or informal ways, characterised by an 'intermediate' level of binding...they are the outcome of investments by a single family or small number of allied families who, once having acquired the component companies, keep them together as a coherent group among which personnel and resources may be shifted as needed. Yet the individual companies continue to keep some separate identity.” (2001: 69-70)

Family-owned business groups dominate the private sector landscape of the country, and the region with Japanese *keiretsus* and Korean *chaebols* (Chang 2003).

2.4.2 Relationship with the State

Why business groups should exist, evolve and be the common form of private sector

organising in the region has been a source of rigorous debate. A variety of theories proffer different perspectives to their enduring existence. Chung looks at six different theories – institutional, failure, transaction cost, resource-based, social capital and agency – to provide perspectives on business group development in developing countries. The table below summarises these theoretical perspectives, with the relevant theories applied in this thesis - institutional, resource-based and agency theories - discussed extensively in the previous section:

Table 7: Theoretical Perspectives on Business Group Development (adapted from Chung 2005)

Institutional theory	Institutional theory asserts that highly diversified business groups create value by compensating for a nation's inefficient capital, labor, and product markets
Market failure theory	Market failure theory, concurring with institutional theory, argues that external markets can fail due to inefficient market mechanisms, legal impediments, and lack of trust
Transaction cost theory	Transaction cost theory argues that internal business transactions lower transaction costs because they avoid costs associated with contracts, negotiations, and contract enforcements.
Resource based theory	Resource-based theory asserts that BG-affiliated companies have opportunities to acquire and accumulate valuable resources, such as industry entry skills, trained employees, managerial skills, export-related skills, and others, giving them resource advantage over non-affiliated companies.
Social capital theory	Social capital theory proposes that intra-firm networks such as BG companies are social capital that can facilitate value creation.
Agency theory	Agency theory argues that because BGs are owned and managed by founder families, agency problems are minimised between professional managers and shareholders.

In studies of business groups in developing economies, their relationship with the state is fundamental. The relationship business groups have with the government of the Philippines defines and influences the manner in which these companies operate. This research is no exception and seeks to contribute to wider knowledge of business group formation and operation in a developing economy.

In the case of the Philippines, the country has less than satisfactory regulatory institutions. Carney supports this notion by proposing four hypotheses of business group development in Asian business groups: institutional voids, life cycle, state-led industrialisation, and crony capitalism (2008:602). Of the four, two are most pertinent to

the country's situation – that of business groups filling the institutional void (Carney 2008: 598) with the provision of infrastructure which is normally the realm of the state, and the proliferation of crony capitalism in the post-dictatorship era which has allowed the persistence of some business groups.

Unlike other countries in the region such as Taiwan, South Korea and Japan, the Philippines did not have an 'interventionist state' (Fligstein 1996) where the relationship between business groups and government were mutually beneficial, united by a common goal towards greater economic development and providing a distinct form of Asian capitalism (Granovetter 2001: 71 73). Instead, the state has played a dysfunctional role similar to the case of business groups in Indonesia (Granovetter 2001: 97). Yet dysfunctional business-state relationships are far from unidirectional as business groups with enough extraterritorial might and political connections can play a pivotal role in overthrowing the elected government of the day as in the case of the Chile's Allende government (Zeitlin et al 1974: 120-121). Indeed, some Philippine business groups actively supported the overthrow of Marcos in the dying days of his dictatorship.

With a dominant public sector and government executive, business groups create a form of organising that tries to mitigate uncertainty. The Philippines has a developing capital market, and the lack of trust in judicial remedy is widespread (See Chapter 9: Corruption). By being part of a business group, transaction costs between affiliated companies are lower and being part of a group may help overcome market failure problems, allows the transfer of managerial talent across businesses, and share other resources between affiliated companies (Kim et al 2004: 28)

The might of business groups and conglomerate power also allows competitive advantage over single firms. As business groups dominate industries, being affiliated with a business group allows a company access to the network and resources available within that group. Being part of a business group builds up and consolidates the social capital amongst members.

In terms of structure, business groups in the country are vertically integrated reflecting a great degree of control by owners (Khanna & Yafeh 2007:333) and Leff saw their structure as substitutes for the imperfections in the capital market (1978: 672). While business groups may be the most *efficient* form in an *inefficient* market, because of their scope and size, domestic business groups have an almost unassailable advantage over new entrants

with foreign ownership restrictions in developing economies – in most cases - unilaterally favouring domestic participants.

As Guillen point out, in sectors where foreign investment is restricted, domestic business groups that have proliferated under such protectionist policies will be reluctant to lose this ‘asymmetrical’ position. Foreign entrants have little choice but to collaborate with them, thus ensuring the continuation of the status quo of the dominance and entrenchment of business groups (Guillen 2000: 376).

The ambivalence towards the domination of a few select groups was provocatively looked at by Khanna & Yafeh in their 2007 article called “*Business groups: paragons or parasites.*” The authors conclude that both types of business groups exist: business group paragons are the ones who have a good reputation premium and practice good corporate governance (Carney 2008: 597) while the parasitic business groups rarely practice good corporate governance and depend largely on the largesse of their political connections (see Faccio 2006) and superior contacts to sustain the viability of their companies (Fisman & Khanna 2004: 621). This parasitic view of business groups provide support for Carney’s hypothesis that some business groups emerged due to the reciprocal nature of crony capitalism.

As discussed earlier in this chapter on the section on agency theory, the common principal-agent problem common in Anglo-American countries are not present in the Philippines as most owners are they themselves part of management. In most cases, the control of business groups has not been decoupled from the owners.

2.4.3 Concentration of Control and the Holding Company

Concentration of control is manifested in the importance of the holding company in a business group structure and how the holding company effectively controls other companies. A phenomenon known as cross-shareholdings allows this complex ownership form to have a major shareholder to control a company or sets of companies even if the owner holds less than the majority stake¹⁸. While not limited to business groups in emerging economies, cross-shareholdings are more common in the business group form than other corporate forms. Chung (2005) tries to make the distinction

¹⁸ Almeida & Wolfenzon (2006) discuss the more aggressive form of cross-shareholdings, known as pyramidal ownership.

between a control-based business groups as opposed to an ownership based business group with the former applying in the case of Philippine corporations:

“A Control Based Business Group (CBBG) is a collection of legally independent companies, which were formerly business units of an Ownership Based Business Group (OBBG), bound together under the control of a founder family or managerial elite by means of interlocking ownership (cross-shareholdings) (Chang 2003; Claessens et al. 2000). In this structure, founder families or managerial elites hold or control relatively insignificant amounts of bona fide ownership shares of their affiliated companies. But, they can inflate their controlling shares by means of cross-shareholdings. When equal amounts of investment dollars are cross-shared between affiliated companies, there is no net increase in invested capital, and yet it gives the controlling stakeholders effective controls over their affiliated companies. Although the amount of cross-shareholdings is not necessarily equal, the purpose of interlocking ownership is to inflate the controlling shares for founder families and managerial elites.” (Chung 2005: 68)

This issue of cross-shareholding of related interests has had a long history. In 1932, in their study of holding companies of major utilities in the United States, Bonbright and Means pointed out the fundamental conflict of interests between the dominant shareholder, its subsidiaries and minority investors. The majority owner will normally exercise control through the holding company which in turn executes strategy by taking into account the entire financial health of the business group:

“...one of the serious weaknesses of the holding company lies in the fact that there is so often a conflict of interests between the holding company, as the dominant stockholder, and the minority stockholders in its subsidiaries. This conflict is generally due to the fact that the holding company is willing to sacrifice the profits of any one of its subsidiaries if in so doing it can increase the profits of the entire group of properties under its control.” -Bonbright and Means (1932: 343)

The strategy of the holding company behaving as the asset manager allows a highly vertical and centralised control over a diversified group of assets or companies. While this form of financing is appealing to “economies subject to risks and uncertainties of

instability and rapid structural change” (Leff 1978: 667), opaque holding company activity directing a web of cross-shareholdings was a factor in family-owned collapses such as that of Parmalat in Italy (Clarke 2007). In the aftermath of the 1997 East Asian Crisis, Korean *chaebols* were pressured to reform to improve transparency in cross-subsidiary activities and to simplify these corporate complex structures (Chung 2005, Li et al 2006).

The strength of business affiliated business group transactions can also be the source of its weakness. In an era that emphasises transparency, related party transactions of business groups must be able to withstand such scrutiny.

2.4.4 Central Role of Banks

A core aspect of a business group’s structure is its bank-based model of financing. Having a bank at the centre of a business group allows a highly controlled form of financing to mitigate the effects of inefficient capital markets and high transaction costs. The bank-based model of financing is not new. Lamoreaux’s study of 19th century New England documented banks of kinship groups were at the core of financing affiliated firms as this provided stability, strength and long-term investment horizons (1986: 659, 666). Sales’ study in Quebec also found that the intense concentration of banking and industrial capital allowed investment in developing large projects (1979: 296).

The parallels between business groups in developing economies and the then developing economy of the north-eastern part of the American continent extends to issues of business risks and longer-term perspective on strategy (Lamoreaux 1986:653) However, unlike New England kinship groups, there is a high cost of entry in establishing a bank in the Philippines (1986: 653,667). While kinship groups were able to contribute to the industrial development of New England, the narrow pool of capital and prevailing institutional weaknesses in the Philippines give rise to a certain amount of inflexibility that prevents the same thing from currently occurring in the country.

Nevertheless, business groups will remain the dominant form of organising in the region. Reforms in the private sector will need to take their dominance into account as they “will continue to be important vehicles for the sustained future growth of this region.” (Chang 2003: 414)

2.5 The Family Business and the Business Family

Business groups in the Philippines are normally owned by families. A strong family-orientated culture permeates both the private sector and public sector spheres of the country with the dominance of business families paralleling the dynastic political families (Dumlao 2006: 38-39).

Therefore, a substantial part of my research unveiled the impact of family dynamics, business family and family business relationships. This section looks at the literature of the specific issues facing family businesses and business families. The first half looks at internal family-related issues, while the second half deals with the external relationship a family has with the business.

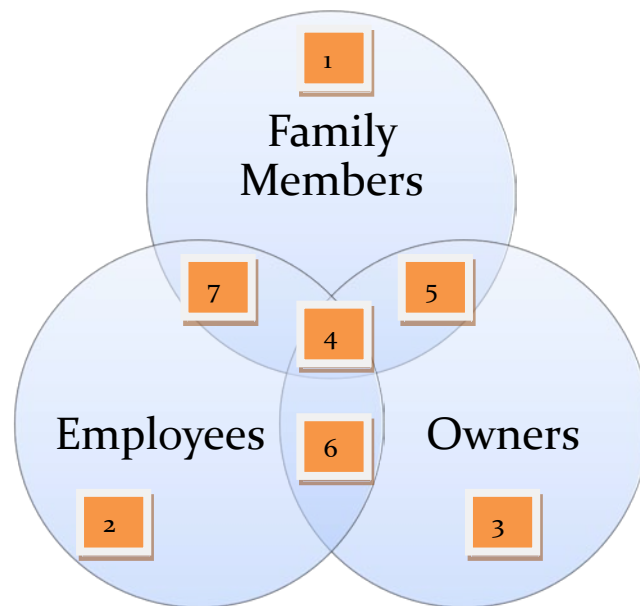
2.5.1 Owners in Management

There are seven stakeholders in a family business (Sharma & Nordqvist 2008). They are:

1. Passive family members and non-owners not involved in the business
2. Non-family employees
3. Non-family owners not involved in the operations of the business
4. Active family members, owners and employees
5. Passive family member-owners not involved in the operations of the business
6. Employee-owners and not members of the family
7. Active family member employees but not owners (Sharma & Nordqvist 2008: 78-80)

The stakeholder groups correspond numerically in the following three-circle Venn diagram which contains the three dimensions of family business ownership – family members, employees and owners. This figure below shows this form of stakeholder mapping:

Figure 4: Seven roles of internal family firm stakeholders (Sharma and Nordqvist 2008: 79)



Sharma and Nordqvist's model is a useful way to understand the different categories and interactions of family and non-family members in the family business. For a family member who is both an employee and an owner (no.4 in the figure), his/her role in the business family is pivotal as s/he represents both management and ownership interests. Family member-owners involved in the business also display the continued operational interests of owners as control is not decoupled from management control (Davis 2008: 141).

2.5.2 Importance of Family Values

Family business literature is replete with management challenges facing a business family. The journal *Family Business Review*¹⁹ provides a comprehensive account of such challenges. However, at the core of what makes a family business different from a non-family business is the notion of values. Family values are fundamental to the family business. Cultural and core values distinguish a family-owned business group from their non-family counterparts. As argued by Ward:

“family businesses are value driven...[pervading] every aspect of a family business....The family's values are the company's culture.” (2008: 2-4)

¹⁹ Family Business Review <http://fbr.sagepub.com/> accessed 6 July 2010

The endurance of family values in a business is also a reflection of the family as society's most fundamental unit and reliable form of 'security' blanket in an insecure, unstable environment:

“...the family is perhaps the most reliable of all social structures for transmitting cultural values and practices across generations.” (Gersick et al 1997: 149)

Non-family firms tend to focus on short-term, transactional, financially driven goals; while family-owned firms tend to emphasise the long-term, intangible and collective goals (Ward 2008:5). A strong family culture also “affects the relationship between family power and the agency/control of the board role in family firms.” (Corbetta & Salvato 2004: 129)

Family firms have a natural fit in the collectivist culture of the Philippines.

2.5.3 Sentimental Value of Ownership

For business families, their members have some form of sentimental or emotional value attached to the business (Zellwegger & Astrachan 2008). This value can be shaped by their upbringing or their experience firsthand of what it means to be a business family member. Below is a table by Birley (1986) displaying the four manifestations of emotional ownership of a family business from weak detachment to strong attachment and belonging; and from positive affiliation to negative resentment:

Table 8: Four Manifestations of Emotional Ownership in Family Firms (Birley 1986: 36)

		Emotional ownership	
		Strong	Weak
Direction of emotion	Positive	Deep sense of belonging and shared fates 'I feel strongly about the family business: it makes me proud. The success of the business is my success.'	Superficial, happy go-lucky 'I'm happy it's there but I don't care that much. It does not define who I am.'
	Negative	Disillusioned and rigid fusion 'The family business gives me pain, but I can't free myself from it. It is part of who I am.'	Superficial rejection 'I'm not bothered with the family business, and I don't feel like part of it.'

Emotional ownership also manifests itself when it comes to succession when sentimental attachment may hinder an objective attitude towards successful succession (Davis 2008: 142).

2.5.4 Succession in Family Businesses

Arguably the most difficult internal business family issue is that of succession or handing over the business from one generation to another (Ward 2008: 3). Andrea Santiago's 2000 study of the '*Succession Experience in Philippine Family Businesses*' provide an excellent insight into how Philippine business families deal with this issue. Santiago's study points to the importance of family values in determining successful succession:

“When the family adopts a succession process that is consistent with the values by which they live, the chances that the succession will be smooth increase, regardless of whether there was formal planning.” (2000: 15)

Santiago's research also found Filipino-Chinese business families were more likely to be guided by the Confucian values of seniority and harmony (2000:16). Her research support Chau's investigation with the succession approaches between co-parcenary traditions which are identifiable with Chinese business families and observed primogeniture traditions which she identifies with Japanese business families. According to Chau (1991), Chinese families tend “to share ownership among siblings when starting a family company...[and] practice a *coparcenary* (joint heirship) approach to ownership succession which divides ownership among each generation relatively equally.” (cited by Gersick et al 1997: footnote 8 in 56). Chau's insight provides a perspective on how ethnic Chinese businesses view succession and the issues that go along with it.

The succession process can be an emotionally difficult issue for business families as a person's mortality is recognised and this is rarely a pleasant topic. Succession is a volatile subject that can easily divide family members. During my fieldwork, several business families were in conflict principally due to succession and some of their struggles were played out in public (Calderon 2007, Salverria 2007). Succession in the family business brings to a head simmering non-related business issues and are a test of the functionality (or dysfunctionality) of a business family. As pointed out by Ward, succession also brings to the fore family values that will be transmitted to the next generation which will be “the core of long-term ownership unity.” (2008: 3):

For outside board directors on a family-owned firm, “it is of utmost importance that [they] are aware of potential conflict of interest issues [on succession]” (OECD 2006: 12), but the long-term future of a family business largely depends on how succession is managed by family members.

2.5.5 Family Council

The existence of a family council becomes pivotal when dealing with contentious issues such as succession as it is a mechanism that mitigates “internal strife and disruption” that may affect the company. (OECD 2006: 12) The following definition of a family council is provided by Gersick et al:

“A family council is a group who periodically come together to discuss issues arising from their family’s involvement with a business. The fundamental purpose of a family council is to provide a forum in which family members can articulate their values, needs and expectations vis-à-vis the company and develop policies that safeguard the long-term interests of the family. (1997: 237-238)

Aside from succession, family councils are an important body for business issues and family-related discussions. Family councils can be formal mechanisms where issues, concerns and/or grievances can be aired amongst the working members, non-working members, owning-members and/or extended members of the business family.

Family councils are normally present in business families that are large, extended and multi-generational. Where the company is largely family-owned, then the family council exerts its influence on the business with representation normally through the positions of Chair, CEO and/or Executive Directors.

Family councils are a pivotal governance mechanism and their existence and role must be appreciated to understand the corporate governance of family-owned business groups. Chapter 7 looks at where family councils fit in Philippine companies.

The next sections look at the two other main challenges that business families face are that of financing and the professionalisation of management.

2.5.6 Financing

Most business families pride themselves in having grown the business by financing

internally normally through their banks. However, when business groups become large and more complex, seeking external sources of finance to fund future investments become a pertinent issue. Going to market or listing on the capital market for family-owned business groups can be an emotionally charged decision. The step of listing is a paradigm shift as the family business is taken to another level: opening up to outsiders and placing the family and the business to scrutiny.

When family businesses list, aside from the financial motivation, ownership and emotional considerations are normally taken into account. Listing may also not receive the unanimous support of all family members and the costs of intra-family conflict may outweigh the benefits of listing (Gersick et al 1997: 54). For families that have managed to continue the business for several generations, the main ownership issue of multiple shareholders may be the catalyst for going public as some family members may wish to cash in their ownership stake. (Gersick et al 1997: 54-55) Being removed from the founder-entrepreneur generation, remote attachment to the business is a compelling argument for going public. For families that are in the founder-entrepreneur and first generation stage, unlocking the value of the family business is a strong financial motivation that will allow the company to expand and to attract outside investors.

From a business portfolio point of view, listing provides a more objective, discerning capital market assessment of the value of a group's companies. Having a controlling owner behind a business group means there is an ultimate oversight of a diverse portfolio of assets. For the ultimate owner/s (and in some cases, managers) of a business group they can assess which listed assets are performing; which company has the highest market value; the best projections for future opportunities; and which companies have the best, competent managers running the company. (McVey 1992:14)

Nevertheless for those business groups who are brave enough to jump through the hoops, listing on the stock exchange has a profound effect on the company with the financial rewards outweighing the administrative obstacles. For families, listing can profoundly alter their relationship or attitude towards the business. Listing is like the double-edged sword - on the one hand, listing can be the catalyst in renewing interests amongst owners while providing a good injection of liquidity for the business; on the other, the emotional issues may include the bittersweetness of selling and losing a

certain amount of control and privacy as the family interests in the business are scrutinised by outsiders. (Davis 2008: 140)

2.5.7 Professionalisation and Professional Management

Another sign of maturity and development in a family business is the introduction of professional managers. Professional family business management is defined as having the “means [of] an in-depth enough understanding of the owner family's dominant goals and meanings of being in business (i.e., cultural competence) to be able to make effective use of relevant education and experience (i.e., formal competence) in a particular family business.” (Hall & Nordqvist 2008: 63)

Dyer posits three ways in which professional management skills can be introduced into the company:

1. Professionalise members of the owning family so they have the expertise to takeover the business
2. Professionalise non-family employees currently working in the business and upskilling these internal candidates; or
3. Bring in outside professional management talent” (1989: 227-228)

The first two options are evolutionary and incremental, while the third option is revolutionary and signals a significant change.

The family business literature is replete with accounts and challenges of professionalisation as business families realise the natural limitation for internally grown management talent (see Hall & Nordqvist 2008, Dyer 1989 and various articles on professionalisation from *Family Business Review*). Professional managers in a business may also improve professional conduct practices and counterbalance the “familiarity” and “familiness” of family businesses as excessive informality in the family business may “lead to unprofessional practices in order to avoid family conflicts.” (Ward 2008:5)

On the board appointment level, it has been argued that for non-listed firms, competent professional outside directors (that may have pre-existing links with the company) is preferable over wholly independent outsiders who have no connection to the owner-controlled firm (OECD 2006: 10).

The career development path of professional managers in family businesses must also be considered as generally family owners try and ensure the senior executive roles are filled by family members or owners' representatives. The issue of nepotism is central in family-owned businesses and resentment may be fuelled amongst outside professional managers who see the careers of family member employees who have not the same qualifications and competence as they progress due to their connections rather than talent. (Donnelley 1988) Where there is excessive nepotism in place, this will place the family business under pressure (Gersick et al 1999: 4-5). Policies regarding mentoring, grooming and/supporting of family employee members by professional managers may help clarify the latter's roles and career opportunities in a family business. (Gersick et al 1997: 128) Similar to listing, professionalisation is a long-term strategy for the viability of the business and its owning family.

2.6 Culture

This section discusses pertinent literature on culture in the Philippines.

Hofstede's (1984) landmark research provides a summary on culture's constituents. Hofstede focused on four dimensions of national culture that were a result of his research into 40 countries which included the Philippines. These four dimensions are: power distance, uncertainty avoidance, collectivism-individualism index and masculinity-femininity index (1984: 72, 118, 148 & 190). The aggregate view of all these dimensions provides a better appreciation of what makes a national culture distinct from another.

2.6.1 Power Distance

In Hofstede's power distance index (PDI), the Philippines was considered the country where there is "an extremely high PDI score" out of all countries surveyed (1984:102). The country topped this index with a score of 94/100 ahead of Mexico (81/100), Venezuela (81/100) and India (81/100).²⁰ The average power distance score was 51/100 with Australia having a low power distance score of 36/100 (1984:77). The consequences of a high power distance culture in organisations include greater centralisation and a hierarchical structure (Hofstede 1984: 107, Figure 3.9). The relationship between superior-subordinate

²⁰ In the second edition of his book, Hofstede had Malaysia's power distance score at 104/100 with the Philippines second (2001: 127).

in a high power distance culture is marked by strong dependency needs, autocratic or paternalistic rule and the acknowledgment of authority. (1984:259)

Arce and Poblador provide support for this delineation of the superior-subordinate relationship. In their study, company managers were encouraged to employ “their own men” thus creating divided loyalties within a company. Superiors protected subordinates who were found guilty of malfeasance, in return superiors commanded loyalty and work efficiencies from subordinates. Policies against nepotism were also not enforced. (1977: 12). Hofstede mentions the colonial legacy in the Philippines and India included organisations that were set up by colonial rulers that strongly emphasised a hierarchical culture (1984:101-102). Similar to the British experience in India, the Americans did not emphasise democracy or equality in Philippines government bureaucracies under their colonial rule. Instead, the Americans chose a few selected elites thus failing to practice democratic principles advocated by them and reinforcing the country’s stratification. The failure to dismantle this hierarchy by local managers after independence ensured this form of organising continued. Indeed the top 7 countries in Hofstede’s power index were all former colonies.

2.6.2 Low Uncertainty Avoidance

In Hofstede’s index, the country scores 44/100 of which the mean is 64/100. It is also lower than Australia which scored 51/100 (1984 122). This places the country as one where the culture tolerates a lot of uncertainty and ambiguity (if not actively embracing it). This is perhaps encapsulated by a comment made from one interviewee who stated: “We thrive in crisis.” Given the disruption in the country’s economic well being for the last 50 years, the ability to live with uncertainty is a trait of the Filipino. This is linked to the strong collectivist culture in the Philippines where the family takes precedence above the state as the state has proven to be untrustworthy. This is also perhaps a reason why family-owned business groups are the most common form of organising in the country (see arguments made by Morck & Yeung 2004 on trust and family control and previous section in this chapter on Business Groups).

Interestingly, Hofstede also points out that the spiritual aspect of the country may have something to do with the level of tolerance for ambiguity (1983:136). While Hofstede found other Catholic countries generally did not tolerate uncertainty, both Ireland and

the Philippines did. Both have strong Catholic cultures and suffered severe historical political-economic disruption at the time the study was conducted. Indeed, religion in the Philippines is strongly embedded and there is an element of certainty in the religious/spiritual side of the country, which perhaps allows the tolerance of the uncertainty on the state/civil side.

2.6.3 Collectivist

This dimension looks at the extent a country's culture is individualist (emphasising the individual or self) or collectivist (group-oriented) (1984:153). In Hofstede's index, the Philippine has a collectivist culture scoring 32/100 in the individualism index which had a mean score of 51/100. This index is topped by the USA at 91/100 and followed by other Anglo-oriented countries: Australia (90/100), Great Britain (89/100), Canada (80/100), Netherlands (80/100) and New Zealand (79/100) (1984:158). The distinguishing features for a highly collectivist include the importance of the family and loyalty, a 'we' consciousness, identification based on one's place in the social system, and the fundamental role of group membership and group decision-making. (1984:171). Responsibility belongs to a group rather than an individual, equally, achievement is emphasised collectively rather than individually.

A highly collectivist culture for organisations emphasises loyalty and sense of duty, insularity with promotion largely based from the inside and done on seniority (1984:174). Accordingly, the collectivist culture of the Philippines complements the high power distance index. Together, this provides explanations for the common form of organising in the private sector where respect for seniority is innate, and consensus decisions are the norm.

2.6.4 Masculine

This index is perhaps the most maligned, misunderstood and controversial out of all the other Hofstede indices. In justifying the use of this index, Hofstede explains:

“This dilemma is the relative strength of nurturance interests (relation with manager, cooperation, atmosphere) versus assertiveness interests (earnings, advancement): of interests which in nearly all traditional and modern societies

are traditionally more ‘feminine’ versus those that are traditionally more ‘masculine.’ (1984:190)

In Hofstede’s index, the Philippines is considered a high masculine oriented country with a score of 64/100 ahead of Australia at 61/100. The mean is 51/100. Japan tops this list at 95/100 with Scandinavian countries at the other end. (1984:189) For this index, Hofstede clusters the Philippines with other former colonies of the US and UK (that of India, Hong Kong, Singapore) as providing the reason why these countries are “masculine risk-takers.” (1984: 219)

A masculine culture in organisations means a career-oriented culture, higher job stress, more industrial conflict, and fewer women in more qualified and better paid jobs; therefore women in more qualified jobs are very assertive. (1984:208)

This index does not refer to gender representation but rather on the stereotypical attributes of male versus female characteristics. Indeed, the Philippines by far has the highest representation of women on senior management level in public government bureaucracies anywhere in the world (The Economist 2007) therefore this index does not reflect this gender achievement. However the interviews I conducted with women do provide support for Hofstede’s reasoning that women in more qualified jobs are more assertive.

2.6.5 Hofstede’s Indices in the Philippines

Hofstede’s research provides some basic generalisation of Philippine cultural norms. In summary, the Philippines according to Hofstede’s study has a very strong hierarchical culture that thrives in an uncertain environment. The country is also highly collectivist with a masculine culture. The following table summarises these points:

Table 9: Hofstede's Cultural Dimensions in the Philippines

Index	Highest Power Distance in All Countries Studied	Low uncertainty avoidance	Collectivist	Masculine
Meaning	Hierarchical culture in organisations; Superior-subordinate relationship of obedience strongly enforced	Embraces risk, disruption and uncertainty especially in political life	Strong family ties, strong religious ties mitigates uncertainty of weak state	Strong assertiveness oriented towards advancement
Score (Mean)	94/100 (51)	44/100 (64)	32/100 (51)	64/100 (51)

Combining two of the indices – that of power distance and uncertainty avoidance, the Philippines typifies the Southeast Asian country as the top right shaded cell in the following table shows:

Table 10: Four Combinations of Power Distance and Uncertainty Avoidance (Hofstede 1984: 216)

Small Power Distance Weak Uncertainty Avoidance Countries: Anglo, Scandinavian, Netherlands Organisation Type: Implicitly structured Implicit model of organisation: market	Large Power Distance Weak Uncertainty Avoidance Countries: Southeast Asian Organisation type: Personal bureaucracy Implicit model of organisation: Family
Small Power Distance Strong Uncertainty Avoidance Countries: German-speaking, Finland, Israel Organisation type: Workflow bureaucracy Implicit model of organisation: Well-oiled machine	Large Power Distance Strong Uncertainty Avoidance Countries: Latin, Mediterranean, Islamic, Japan, some other Asian Organisation type: Full bureaucracy Implicit model of organisation: Pyramid

Following from Hofstede's assessment, the following chapters in this thesis provide support on why the implicit model of organising in the Philippines is based on the family. The cultural elements of the country provide a reason for - and complements - the enduring dominance of family-owned business groups in the country and in the region.

2.6.6 Conflict Avoidance – An Additional Cultural Element

While Hofstede's study is remarkable, his perspective on culture based on four dimensions and its applicability can be limiting and McSweeney (2002) has questioned

Hofstede's model of national culture and called it "profoundly problematic." Davel et al (2009) tries to address some of Hofstede's oversight by looking at a more extensive plausibility of culture's impact by studying the cultural perspective of business and management across continents. Specifically, their study includes the problems of the classical approach towards intercultural management and understanding, the place of ethics in a globalised world, and specific aspects of cross-cultural management in different societies.

This thesis does not intend to engage in cross-cultural debate (as it would be beyond its scope), nevertheless, Hofstede's model provides a basis where some understanding of culture can be notionally made with certain caveats as I found during my field work. Thus, providing a local understanding of Filipino culture comes courtesy of Teehankee (2004). Teehankee points out the nexus of Asian and American influences inherent in Filipino culture with strong elements of Confucian culture infused especially in Chinese-Filipino owned business organisations. These elements include a paternalistic authority presiding over the organisation, succession and treatment according to family relationships. Lee-Chua (1995) also emphasises the importance of familism, personalism or familiarity that determine business conduct in the country.

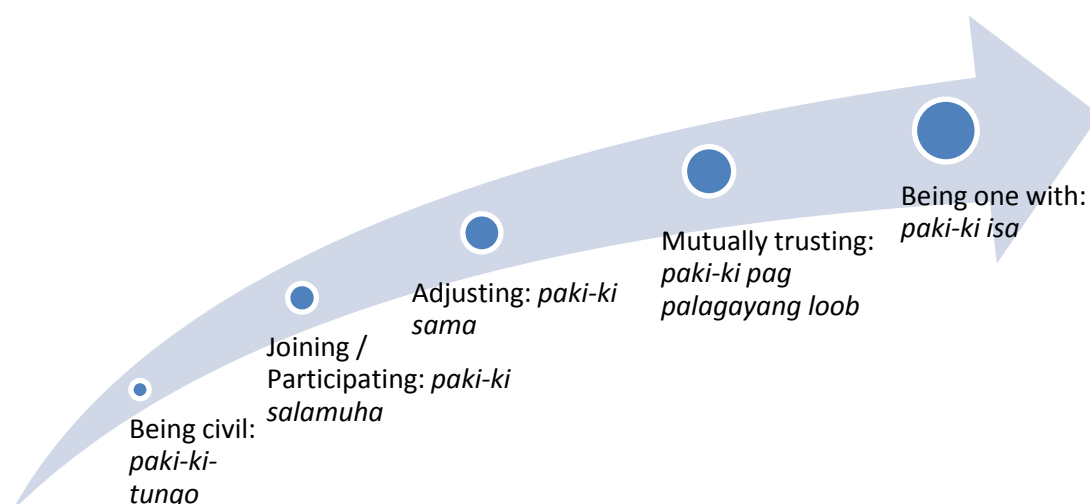
Related to Hofstede's individualistic-collective index is the measure of self-reliance-reciprocity (see Jocano 1980). Individualistic cultures tend to be self-reliant but in the Philippines, reciprocity or plainly put: "I scratch your back, you scratch mine" is part of belonging in the culture: "Reciprocity highlights the Filipino concern for interdependence or being part of a network of social obligations by debts of gratitude (or *utang na loob*)."

(2004: 196). Failure to reciprocate is intricately linked to that other cultural notion of losing face (or *hiya*).

Hofstede catalogued the country as being able to live with high uncertainty. Additionally, the country also tends to rate highly on avoiding conflict and confrontation. High conflict avoidance in the Philippines is encapsulated in the concept of smooth interpersonal relationships (or SIR) which is a variant of the Confucian concept of social harmony and is part of social acceptance in the Filipino context (Lynch 1981). Social acceptance is also encapsulated in "getting along" or *pakikisama*. Several interviewees mentioned this as an element that defined Filipino culture (see Chapter 4)

The highly collectivistic nature in the Philippines may blur the lines between work and leisure, professionalism and personalism (Teehankee 2004: 220-221). The degree of social acceptance also moves along a hierarchy akin to the Maslowian hierarchy of needs (1943) where the self-actualisation equivalent is being one with the other. Reproduced in the following figure is this path of social acceptance adapted from Lapeña's 2002 model:

Figure 5: Path of Social Acceptance adapted from Lapeña (2002) cited in Teehankee (2004: 225)



Integrating the perspectives provided by Hofstede and Teehankee, the main cultural underpinnings of the Philippines are summarised in the table below:

Table 11: Integrating Hofstede and Teehankee's Cultural Dimensions in the Philippines

High Power Distance and Elitism	Conflict Avoidance and Social Harmony
Live with Uncertainty and Volatility	Collectivist and Family-Orientation

The culture of the Philippines emphasises high power distance and a highly elitist culture; conflict avoidance and social harmony, the ability to live with uncertainty and volatility, and a culture that appreciates the collective and the importance family plays in society. Chapter 4 provides evidence for these cultural elements, in particular, the irony of a collectivist culture that is at the same time exclusivist or elitist.

2.7 Corruption

This section reviews pertinent literature on corruption. Chapter 9 looks at the evidence and effects of corruption in the country. Corruption is defined as:

“...behaviour which deviates from the formal duties of a public role because of private-regarding (personal close family, private clique) pecuniary or status gains; or violates rules against the exercise of certain types of private-regarding influence. This includes such behaviour as bribery (use of a reward to pervert the judgment of a person in a position of trust); nepotism (bestowal of patronage by reason of ascriptive relationship rather than merit) and misappropriation (illegal appropriation of public resources for private-regarding uses).” (Nye 1967: 419)

For Rose-Ackerman, “corruption occurs where private wealth and public power overlap. It represents the illicit use of willingness-to-pay as a decision-making criterion.” (2008: 330), Gupta and colleagues looked the contribution of corruption towards income inequality and poverty (2002) while Xin and Rudel notes corruption emerges where “market economies are small or economic exploitation is great, governments collect few taxes and pay their public servants little. Under these circumstances, officials use their power to supplement their incomes through corrupt transactions”. Coupled with the lack of trust present in corrupt environments, this “mistrust probably elevates the amount of corruption that citizens perceive among their public officials.” (2004: 298).

Corruption, in the Philippines, is sadly endemic and unpredictable. This is not to say corruption has always been present in the country. Indeed, Strachan’s study of Nicaraguan business groups showed the corruption in Nicaragua made investors favour the Philippines in the shipbuilding industry:

“Corruption also had an immediate and negative impact on the development of local industries...[Nicaraguan shipbuilding companies] in spite of some excellent natural comparative advantages, lost out in competition to the Philippines due to government corruption, administration inefficiency, the abuse of labour, climate and pirates. To this day, governmental corruption remains a fact of business life in Nicaragua.” (Strachan 1976:113)

This passage will be familiar to those who are doing business in the Philippines. But this may also provide a perspective the country’s climate of corruption has lingered for far too long and has definitely overstayed its welcome.

2.7.1 Unpredictability

While corruption is prevalent in East Asia (Gill and Kharas 2007: 313), there is increasing focus on the degree of its predictability to affect the effective functioning of governments and economies.

Lee & Oh (2007) classified the variances of corruption in 12 Asian countries according to its pervasiveness and arbitrariness. They noted two countries in particular – Indonesia and the Philippines – were affected by political corruption that occurred during their dictatorships. Their study lends support to the belief that while these two dictators were in power, blame could be centralised as corruption itself was centralised. In effect, corruption perversely was predictable during this period (2007: 100-101). However, once the dictators lost office, unpredictable corruption reigned supreme and it is this variability that has had the detrimental effect. Hutchcroft's 1998 work which looked at the applicability of Weberian bureaucracy in Philippine institutions and its limitations²¹

²¹ In particular this following passage looks at the constraints in visualising a working Weberian polity in the Philippines:

"In employing the patrimonial framework, however, it is important not to obscure four critical differences between the postcolonial Philippines and the economies societies and polities analysed by Weber many decades ago. First, except during the Marcos years, the postwar Philippines has not had the clearly identifiable central ruler that Weber, expected to see in patrimonial polities. Instead, a nominally strong president of relatively short tenure must make major accommodations to "local patrimonial lords" who possess economic power and assume quasi-military and quasi-judicial functions in their localities, and are represented at the national level in a power legislature. Even under Marcos' relatively more centralised form of patrimonialism, the entrenched power of the oligarchy greatly limited his scope of action. Second, Weber would not have imagined the strengthening of patrimonial features in a modernising economy. Particularly strange, from his standpoint, would be the existence of a decentralised form of patrimonialism in the midst of a money economy well integrated by trade and modern communications. Third, Weber's notion of historical progression does not anticipate the 'neopatrimonialism' that comes in the wake of a more 'rational-legal' colonial state. He probably would have considered it especially anomalous to find patrimonial features in the ex-colony of the world's most advanced industrial power...The fourth difference is the most fundamental one, and is closely related to the other three caveats as well. Simply put, Weber's patrimonial polities were far more self-contained than the postcolonial Philippine polity. On a deeper level, one can say that the major reason that patrimonial features in the Philippines diverge to such an extent from those found in Weber's polities lies in the contrast between the external factors that shape the Philippine polity and the external environment in which Weber's polities existed. One cannot begin to explain the perpetuation and maintenance of the Philippine state without a careful examination of the particularities of its colonial heritage and postwar international environment. Precisely because Weber did not anticipate the colonial and post-colonial conditions that help perpetuate the existence of weak states, he would not have anticipated anything quite like the postcolonial Philippine state. Indeed, the Philippine state does not even fit Weber's basic definition of a state; it lacks an effective monopoly over violence and taxation, and it is too weak to maintain control over much of its territory." (Hutchcroft 1998: 41-42) It must be noted that this thesis complements Hutchcroft's existing treatise on the applicability of Weberian notions on

noted that it was the “great variability of corruption” and less its prevalence that has a more serious effect on economies. He argues:

“...corruption per se is not incompatible with advanced capitalism; indeed one can think of myriad examples where the two thrive simultaneously. Rather, it is the highly variable corruption that most impedes ‘the development of rational economic activity.’ (1998: 41)

Arbitrariness is also linked to undermined investor confidence (both local and foreign) as it creates uncertainty which is detrimental to long-term planning and economic development. (Hutchcroft 1998: 253)

Unpredictable corruption also has an effect on the bureaucracy. Where other countries in the region have had bureaucratic corruption, this did not hinder positive economic development (see Leff’s 1964 discussion), but the politicised bureaucracy in the Philippine has not been able to do the same due in large part to the unpredictability or uncertainty of political will. The experience of corruption in Korea (Kang 2002, Dalton 2005) was more predictable with the tendency for public officials to leave businesses alone after paying facilitative fees upfront:

“...in the Republic of Korea, although corruption was pervasive (at the time of writing in the early 1990s), the person paying the bribe was assured of getting the government good that was being paid for and would not need to pay additional bribes.” (Gill and Kharas 2007: 327)

Gill and Kharas also argue centralised corruption worked better as decentralisation created uncertainty (2007: 32, 34). The next sections look at the following forms and categories of corruption.

2.7.2 Low-level Opportunistic Pay-Offs

According to Rose-Ackerman low-level opportunistic pay-offs “lead to the inefficient and unfair distribution of scarce benefits, undermine the purposes of public programs, encourage officials to create red tape, increase the cost of doing business and lower state legitimacy.” (2008: 330-331) Not so dissimilar from the traditional principal-agent

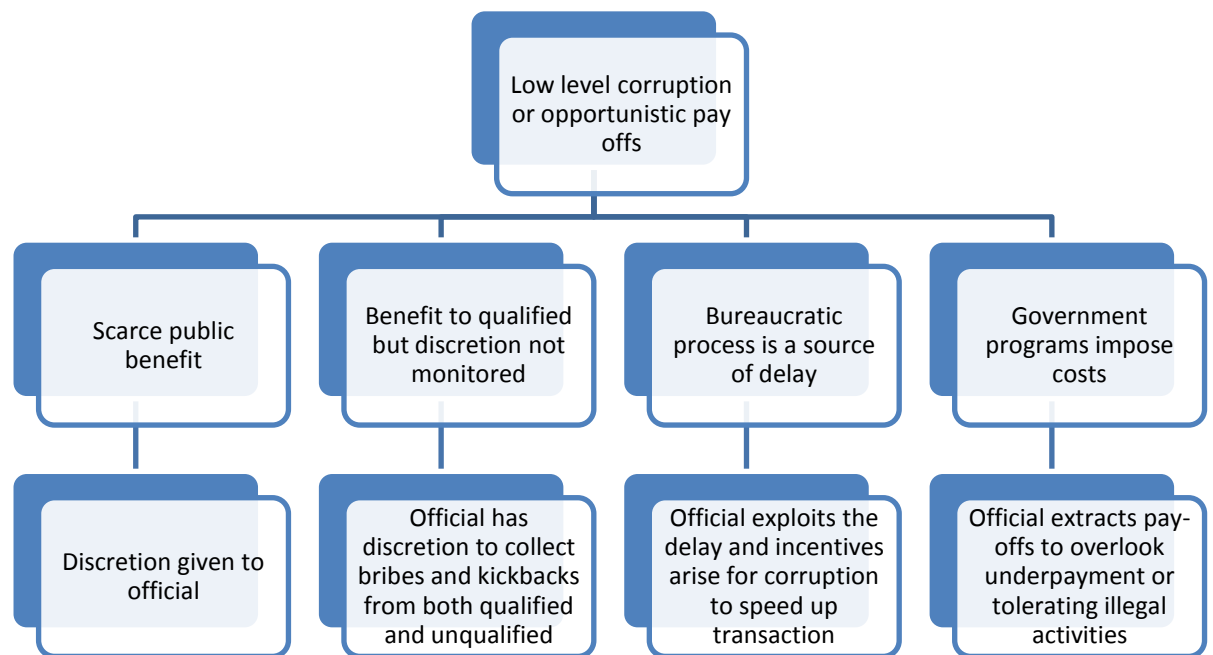
bureaucracy in the Philippines by giving practical examples to support it, rather than providing new theoretical knowledge in this area.

problem present in agency theory, Rose-Ackerman adapts this to describe the problems inherent in the activity of bribing where the principal is the secretary or minister, and the agent is the official who is the subordinate (and independent) of the principal:

“Frequently, bribes induce official to take actions that are against the interests of their principals, who may be bureaucratic superiors, politically appointed ministers or multiple principals such as the general public. Pathologies in the agency/principal relation are at the heart of the corrupt transaction.” (Rose-Ackerman 2008: 330)

Low-level opportunistic payoffs occur in the following generic situations and summarised in the figure below.

Figure 6: Summary of low-level opportunistic payoffs (adapted from Rose-Ackerman 2008)



The first category that allows opportunistic pay-offs is when there is a ‘scarce public benefit’ which allows officials the discretion to “assign” this benefit to the one “with the highest willingness to pay and the fewest scruples will get the benefit in a corrupt system.”(Rose-Ackerman 2008: 330)

The second category allows officials to render benefits to those who are qualified (such as those who are recipients of disaster relief) but monitoring of the officials is imperfect,

hence officials may be able to collect bribes and kickbacks to those who are both qualified and unqualified. Lack of monitoring or controls give the officials a tremendous amount of discretion to be exercised. (Rose-Ackerman 2008: 330)

The third category, delays in the bureaucratic process, is manifested in long queues that deal with administrative matters such as procuring or buying a licence (driver's, business etc). These administrative hurdles or barriers provide "Incentives for corruption arise as applicants try to get to the head of the queue or manoeuvre through a complex set of requirements. To exploit their corrupt opportunities, officials may create or threaten to create more delays as means of extracting bribes." (Rose-Ackerman 2008: 330-331)

The last category is nominally to do with government programs that by their mandate provide a source of revenue: "Some government programs impose costs e.g. tax collection or possibility by the police. Officials can then extract pay-offs in return for overlooking the illegal underpayment of taxes or for tolerating illegal activities such as smuggling of both contraband and ordinary goods that are subject to rationing. Even if people are not evading the rules, officials demand pay-offs in exchange for refraining from arresting them on trumped-up charges." (Rose-Ackerman 2008: 331)

Chapter 9 looks in detail examples of low-level opportunistic pay-offs in the country.

2.7.3 Grand or Systemic

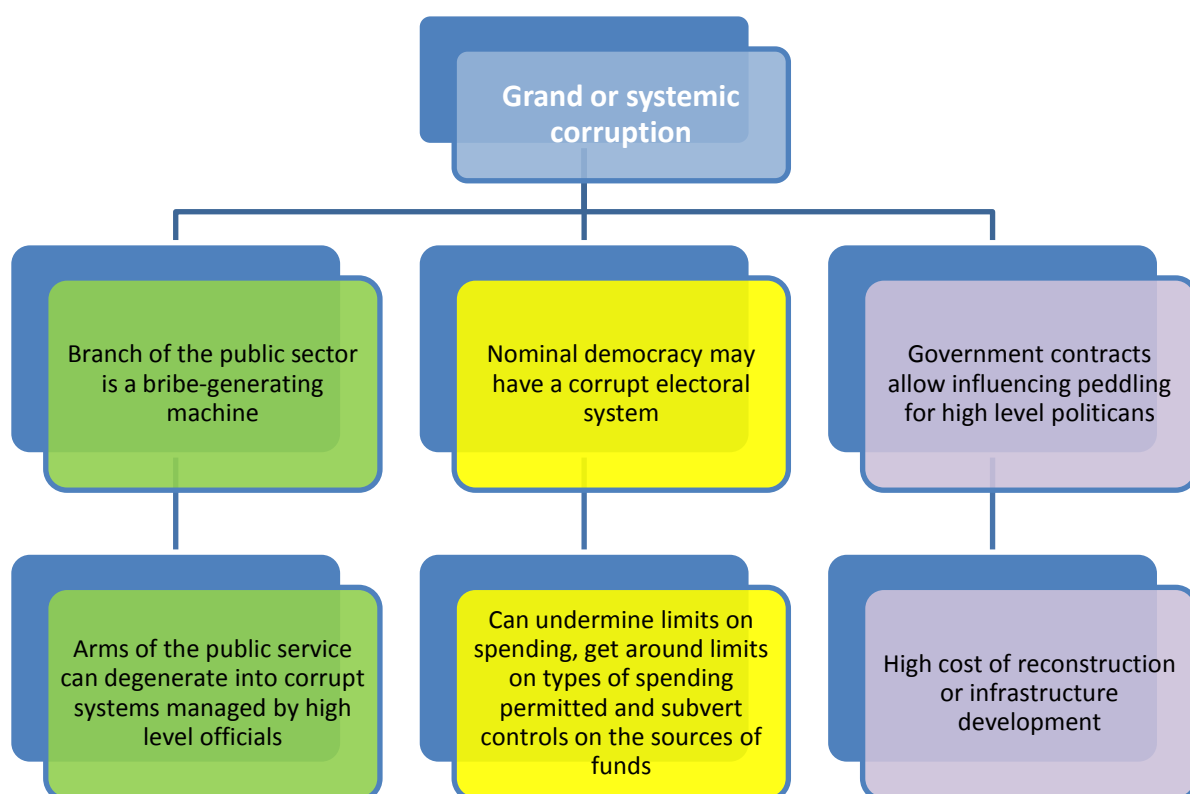
Grand or systemic corruption is corruption on the systemic level affecting the whole of government. In grand corruption, accumulated corruption of low-level opportunistic pay-offs have become institutionalised. Instead of being seen as an anomaly, it is part of life:

"[Systemic corruption] implicates an entire bureaucratic hierarchy, electoral system, or governmental structure from top to bottom...when corruption reaches the highest levels; it is also likely to prevail lower down as a way of buying the support of petty officials." (Rose-Ackerman 2008: 330)

There are three features of grand corruption. This form of high level corruption is characterised by a branch of government being a mere bribe-generation machine; having a corrupt electoral system; and government contracts being politicised highly influenced. While low-level corruption is an irritant and a cause of resentment, grand corruption is

an indication of a profound malaise and “can be more deeply destructive of state functioning bringing the state to the edge of outright failure and undermining the economy.” This is true especially for “a post-conflict state that is already fragile can be a breeding ground for high-level malfeasance.” (Rose-Ackerman 2008: 331) The following figure shows the effects this type of corruption has on the public sector, the country’s citizens and the cost to government:

Figure 7: Grand or Systemic Corruption (adapted from Rose-Ackerman 2008)



While the Philippines is not a post-conflict state like Afghanistan or Iraq, various and bloodless coups d’état over the years especially from sections of the military have created an unstable and fragile nation-state. This gradual descent into dysfunctionality has permeated sections of the bureaucracy, the electoral system and at the same time, strengthened the hold of oligarchical political families while further disempowering the majority of the populace.

The next section provides a background on forms of systemic corruption present in the country: judicial, electoral and in bidding for government contracts.

2.7.3.1 Judicial Corruption: *Les Cahiers de Doléances*

“Fortunate is a land that lives in confidence under the rule of law, with elected parliaments, uncorrupted officials and independent judges.”

- Former Australian High Court Justice Michael Kirby in Marr (2009b)

In pre-revolutionary France when the power of the King was absolute, *les cahiers de doléances* - or formal lists of grievances – were a way to let the absolute ruler know of his subjects’ discontent.²² In Sawyer’s study of *les cahiers de doléances* submitted under the reign of Louis XIII, the grievances “contain articles of all kinds suggesting fiscal, legal and social reform...and requested the king to solve almost every major financial, administrative and social problem in the realm (Sawyer 1988: 98, 102)

On grievances of a legal bent, “the *cahiers* were highly detailed in dealing with legal matters because they were clearly intended to provide the Crown with the necessary information and the political mandate to initiate reform legislation. The specific accusations of judicial corruption in the *cahiers* are all the more significant in view of the fact that a high proportion of deputies [cf. congressmen or members of parliament] were legal officials or legal practitioners of some kind.” (1988: 98)

Of position and power, the grievances evoke the stratified society of the time and the lack of trust in the interpreters and decision makers of the law as “the large number of articles concerning judicial abuses and corruption...focus on problems that many of the deputies must have witnessed first-hand – irregularities in procedure, ineffective procedures, nepotism, the excessive venality of judicial officials, the costs of litigation, delays and subterfuges engendered by the appeals process, and improper conduct on the part of a wide range of judicial officials – from presidents and sergeants-at-arms to court-appointed trustees handling property sequestered by the courts.” (1988: 103-104)

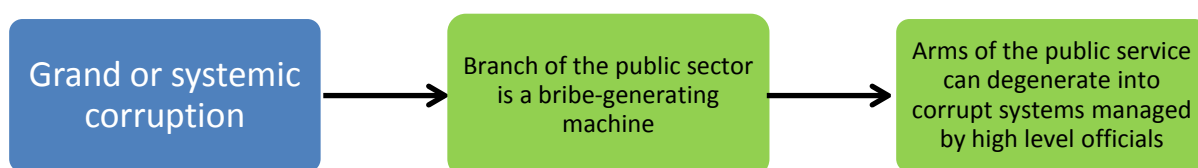
The insular and incestuous circle of the judicial elite was reflected in the “venality...of judges and legal officials using their public offices for private gain. Nepotism, fraud, subversion of due process, and abuse of influence were other ways in which judges, lawyers and lesser officials worked the system to their advantage. The nobility and clergy painted a grim picture of judicial tyranny in jurisdictions where a single family or faction had gained control of the local sovereign court.” (1988: 107)

²² A more comprehensive history and content analysis of “*les cahiers de doléances*” submitted in the years immediately before the 1789 French Revolution can be found in the magisterial work by Shapiro et al (1998).

Other instances of corruption described in the *cahiers* were fraud, extortion, incompetence, abuse of influence, illegal procedures and improper dispensations (1988: 109). In the end, history is the judge of these *cahiers*. 17th century France was an unstable environment wracked internally by religious wars and externally by conflicts waged against Habsburg dominance of Europe. The powder keg that was feudal France erupted 150 years later with the storming of the Bastille. A terrible beauty was born that forever changed the political landscape of Europe.

The *cahiers* provide an insight in the populace's discontent, however the content of these documented grievances share thematic criticisms in the current Philippine legal system. History will again be the judge on how the present legal grievances in the country are (un)addressed. The problems in the Philippine judiciary show the systemic corruption present in this branch of society.

Figure 8: Branch of the Public Sector is a Bribe-Generating Machine

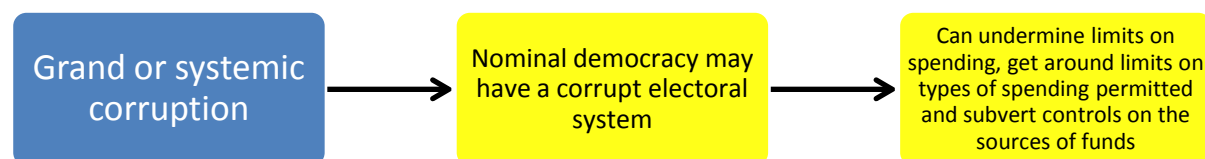


Chapter 9 looks in detail examples of systemic corruption in the judiciary in the Philippines and observations from the private sector on how it affects the perception of the country as lacking the rule of law.

2.7.3.2 Elections

The second type of grand or systemic corruption is manifested in the electoral system with a nominal democracy as the following figure shows:

Figure 9: Nominal Democracy may have a Corrupt Electoral System



In Australia, the administration of federal elections is done through the Australian

Electoral Commission (AEC).²³In the case of its federal election in 2007, the results of the voting were known by the end of the day with the country electing a new Prime Minister. By all intents and purposes it was a successful election. The administrative body was successful in its role as it did not make nor was it the source of any news (except to pronounce the results of the voting).

In contrast, in the Philippines, presidential and senate elections are prime opportunities for corrupt behaviour to present itself. An example of the corruption of the electoral process is over the issue of vote-buying which has long been documented in the Philippines. In 1978, Rose-Ackerman noted the Philippines as exemplifying this type of corruption:

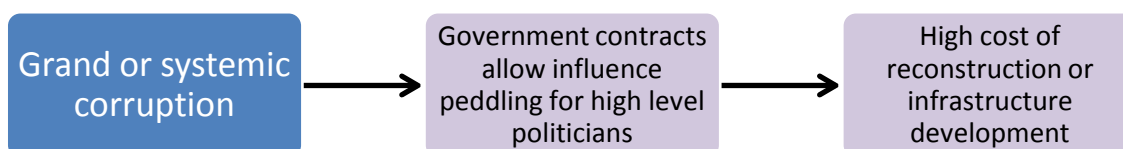
“The best contemporary example is the Philippines: Direct per capita campaign expenditures are the highest in the world and in addition, 10-20% of the electorate is reported to sell its vote; wealthy elites provide most of the campaign funds in the hope that individualised benefits distributed at election time will prevent the poor from organising to dislodge the wealthy from power.” (Rose-Ackerman 1978: 38)

The administrative body, the Commission for Elections (COMELEC), in some cases was and made the news. Results of the voting in the 2007 Philippine senate elections were not known until at least some weeks afterwards. Chapter 9 looks in detail the 2007 elections and its aftermath.

2.7.3.3 Bidding for Government Contracts

The third type of grand or systemic corruption is bidding for government contracts as the figure below shows:

Figure 10: Government Contracts allow Influence-Peddling for High-Level Politicians



Out of all the three types of systemic corruption, this type of corruption actively engages

²³ http://www.aec.gov.au/About_AEC/index.htm accessed 23 March 2009

the private sector. Grand corruption brings “the state to the edge of outright failure and undermining the economy.” (Rose-Ackerman 2008: 331):

“...governments regularly contract for major construction projects, allocate natural resource concessions and privatise state-owned firms. High level politicians can use their influence to collect kickbacks from private firms. If the conflict destroyed a country’s infrastructure, this type of corruption will be a particular risk because of the high costs (and the potential for high kickbacks) of the reconstruction effort.” (Rose-Ackerman 2008: 331)

Corruption in Philippine infrastructure projects is rife and this is where most private sector participants of this research lamented the state of dysfunctionality in their relationship with government counterparts.

2.7.4 Effect on Poverty and Corporate Governance

Corruption contributes to the large presence of the informal sector of the country. Where a predatory state “squeezes the formal sector without pity and without limit” an informal economy follows (Marcouiller & Young 1995: 630). The high presence of the informal economy in the country is only matched by corruption’s poignant effect on the country’s poverty.

Endemic corruption and endemic poverty are intricately linked. Poverty increases corrupt activities while corruption contributes to poverty. According to Xin and Rudel, poverty creates opportunities for corruption and engenders such a culture (2004: 298):

“When market economies are small or economic exploitation is great, governments collect few taxes and pay their public servants little. Under these circumstances, officials use their power to supplement their incomes through corrupt transactions. A culture of corruption emerges from these impoverished settings.” (2004: 298)

Corruption’s vicious cycle is well-documented in various studies (Heidenheimer & Johnston 2008) that show how it is detrimental to growth, inefficient allocation of public resources and deterrence of foreign investment. (Gupta et al 2002: 24) In an extensive quantitative study on how corruption affects income inequality and poverty, Gupta et al note its effect on the whole of society:

“Corruption can affect income inequality and poverty through various channels through various channels including overall growth, biased tax systems, and poor targeting of social programs as well as through its impact on asset ownership, human capital formation, education inequalities and uncertainty in factor accumulation.” (2002: 25)

Thus, Gupta et al’s study supports the business group theories of market failure and resource dependence as high ownership concentration in the private sector is symptomatic of endemic public sector corruption. (2002: 26). Their study also indicates how a small increase in corrupt activity has a significant negative effect on the poor (2002: 37). Corruption’s effect on poverty cannot be understated. To address poverty in the Philippines, corruption must be tackled:

“Policies that reduce corruption will most likely reduce income inequality and poverty. The evidence gives support to political economy considerations that benefits of corruption and bribing public officials are captured primarily by the rich and better-connected individuals.” (Gupta et al 2002: 38, 40)

Corruption and poverty go hand-in-hand. Corruption is symptomatic of a society that is unequal and unstable.

Finally, there is emergent literature on the impact of corporate governance and corruption. In a 2005 paper, Xun Wu suggests that improved corporate governance contributes to addressing and even reducing corruption. Wu states that increased transparent practices may provide a catalyst to corruption’s stranglehold and break up the vicious cycle:

“Corporate governance can well become a critical ingredient to break a vicious cycle of bribery and corruption. This vicious cycle starts when firms are forced into bribery practices because of a high level of corruption, but widened participation of firms in bribery practices further feeds into the perception of high corruption, which in turn makes the bribery practices even more uncontrollable. The analysis of the linkage between corporate governance and corruption suggests that the improvement in corporate governance may be a catalyst to break the vicious cycle of bribery and corruption. Companies with better corporate governance have better prospects of growth and command

higher valuation in the market....better corporate governance also helps reduce bribery practices at the firm level, which potentially can further increase the valuation of firms. At the country level, improvement in corporate governance may help a country with high level of corruption to partially offset the negative impacts of the perception of corruption on the flow of capital (both financial and human), and the additional capital induced by good corporate government serves as catalyst for further improvement in both corporate governance and the governance of the public sector.”(2005:168-169)

Wu’s point that practising good corporate governance rewards the practitioners is supported in a 2002 McKinsey and Company Global Investor Opinion Survey which found there was higher valuation for better governed companies in corrupt environments. The premium investors would pay for a well governed company in the Philippines was an average of 22%. (McKinsey 2002: Exhibit 4) Similar results were found by Durnev and Kim in their survey of 859 companies in 27 countries, supporting the financial link of well-governed companies in not so well-governed countries:

“...an individual company’s reputation for effective governance and transparency scores is more important than the surrounding legal environment in determining its value; or to put it another way, companies can rise above their legal settings....[C]ompanies with higher governance and transparency scores command higher values—and that this governance valuation effect is more pronounced in countries with weaker legal systems. These results send a powerful message of hope to companies, investors, and policymakers in emerging economies with limited institutional protection of minority shareholders. Companies that establish and maintain reputations for good governance and transparency are likely to be rewarded by investors with higher valuations.”
(Durnev & Kim 2007)

Chapter 9 looks at the impact of corruption on Philippine society and how corporate governance in the country is shaped by its presence in the business environment.

CHAPTER 3: METHODOLOGY

This chapter discusses the method I have undertaken for this research. The following table summarises my research methodology:

Table 12: Summary of Research Methodology

Research Design	Qualitative – Ethnographic style approach combining deductive (hypothesis testing) and inductive inquiries
Research Question	What is the impact of post-1997 corporate governance reforms in Philippine institutions and Philippine firms?
Data Collection and Method	Triangulation: Interview Questionnaire, Media Articles and Participant Observation
Unit of Analysis	Corporate governance institutions and firms in the Philippines
Data Analysis	Computer program: NVivo

My research design is an ethnographic style approach combining both deductive and inductive aspects of qualitative research. With regards to the deductive method, my research contributes to different theories and their further development by testing hypotheses rather than generating them. With regards to the inductive aspects, I used elements of ethnographic research to place those hypotheses development within the context of the wider, richer business environment. I collected data using the triangulated method of in-depth interviews, collection of media articles and personal participation. My unit of analysis was corporate governance institutions and firms and I analysed the data using the computer program, NVivo.

3.1 Previous Research

In designing the research, it is useful to provide a brief summary of previous research that have briefly touched on corporate governance in the Philippines. Quantitative research into corporate governance in the East Asian region after the crisis is substantial (see Claessens, Djankov & Xu 2000, and Mitton 2002). Pertinent post-crisis Philippine country studies I have come across include a monograph by the Australian Department of Foreign Affairs and Trade (DFAT) East Asia Analytical Unit called *The Philippines: Beyond the Crisis* (1998) and an edited book called *The Philippine Economy* by Balisacan and Hill (2003).

Studies of the Philippine business environment focus on the economic divide between

the rich and poor and studies into ethnic Chinese-Filipino businessmen and their over-representation in the economy (Datt & Hoogeveen 2003; Armstrong et al 2001; Jomo & Folk 2003). Echanis (2006) explored corporate governance in the Philippine financial services while Dumlao (2006) look at its economic assessment. On a micro level, Santiago (2000) used a case study approach to find about the succession planning experiences in Philippine family businesses. Across the Celebes Sea, Sato examined the corporate governance of six business groups in Indonesia (2004) and also applied a case study approach. The Indonesian business environment shares some similarities with the Philippines – high concentration of family ownership and an over-representation of ethnic Chinese businesses. The Santiago (2000) and Sato (2004) studies demonstrate how a qualitative approach towards corporate governance can yield a broader understanding of the corporate governance environment of a country.

Specific publications on Philippine corporate governance include The Philippines chapter by Cesar Saldaña in *Corporate Governance and Finance in East Asia* (ADB 2001), Celso Vivas' practice-oriented handbook on corporate governance in the Philippines (2003), two chapters on Philippine corporate governance by Alfonso et al (on engaging the private sector into incorporating corporate governance reforms) and Lamberte & Manlañit (quantitative study on Philippine financial institutions) appear in Ho's 2005 edited book on South East Asian corporate governance. Finally, there is also Gregorio Navarro's (2007) edited book on specific company case studies in Philippine corporate governance.

3.2 Contribution of this Research

Where my research provides a unique perspective is the approach I have taken. I have applied the ethnographic method. Compared to previous research that have in large part been quantitative and qualitative case studies surveys into Philippines corporate governance, my research uses the ethnographic method to discover the profound impact of corporate governance reforms on organisations and firms. My research also fills the void in providing greater understanding of the complicated dynamics involved in business-government relationship in the context of the introduction of corporate governance reforms. This approach provides an overall picture from the macro-, meso- and micro perspective that allows the reader to see corporate governance reforms in the Philippines in context – that it was not introduced or implemented in isolation, but as

part of a process that has multiple players, stakeholders (and their various interests) and histories.

Formulating the research topic to come up with something doable, achievable and something new was the reasoning behind pursuing this qualitative method of research. The results in this research bear witness to the field of contests and tensions when these reforms were introduced. How did these reforms come about? How were they introduced? What was the reaction? What wasn't considered? What is the long-term outcome of these reforms?

Thus, I had no hesitation in ensuring that the design of my research was qualitative in order to gain a richer, profound and wider understanding that mere statistics could not unveil. Indeed, Claessens et al (2000) quantitative study provides an indication but not an explanation of why concentration of corporate ownership in the Philippines and other parts of East Asia are high. My results chapters (especially 6A) complement their quantitative survey by providing evidence on why such a state of ownership exists in the country, and in turn provides support for Carney's (2008) treatise on development of business groups.

The findings of my research provide a contextual account of corporate governance in the country.

3.3 Research Question

My research is motivated by the following overarching research question:

What is the impact of post-1997 corporate governance reforms in Philippine institutions and Philippine firms?

The structure of this question is as follows:

- Post-1997 signifies the period of study. The pivotal year is 1997 which is the year of the East Asian crisis. The research proposes to study corporate governance reforms that were implemented after the crisis.
- Corporate governance reforms primarily refer to the OECD Principles of Corporate Governance; secondly they refer to other relevant codes and principles of corporate governance that have been applied in the Philippines by external multilateral

bodies such as the international financial institutions (IFIs). The theoretical bases are institutional isomorphism, and convergence theory.

- Philippine institutions include government and private sector regulatory bodies. The theoretical bases are institutional isomorphism, politicisation.
- Philippine firms refer to private sector firms and they include firms that are family-controlled, ethnic-based, government-owned and foreign subsidiaries. The nature of Philippine corporate ownership and control is such that publicly listed firms are, in most cases, privately owned usually by family holding companies. The theoretical bases are agency theory, resource-based view, business groups and stakeholder theory.

3.4 Research Design

The design of this research uses an ethnographic approach combining both deductive and inductive form of inquiries. The ethnographic method is used to understand the 'insider's point of view' (Gibson & Brown 2009: 49). According to Angrosino, "Ethnography is the art and science of describing a human group – its institutions, interpersonal behaviours, material productions, and beliefs." (2007: 14) and its researchers are "primarily concerned with the routine, everyday lives of the people they study." (2007: 15). Furthermore, ethnographic methods are used when "the social issues or behaviours are not yet clearly understood." (Angrosino 2007: 22).

The approach I have taken fits in the ethnographic style as I wanted to find out the meaning of corporate governance to people and understand the context of corporate governance reform in the country. Having a qualitative research approach allowed me to study the phenomenon of corporate governance in the Philippines in situ.

Had I focused on studying existing financial data in the Philippines, as others have done before such as Claessens et al (2000) ground breaking work on control and ownership in the region, it would not have explained the context such as the political and business environmental factors that shape corporate governance in the country. In this sense, generating data than using existing one allows a deeper layer of meaning and understanding why concentration of ownership is justified in an unstable political environment.

This research follows Geertz's (1973) 'thick description' which attaches importance to the

details of actions and events that provide meaning and understanding – in this research, of how corporate governance was shaped informed and introduced in the country. The analogy of the ethnographer as traveller, translator and discoverer was pointed out by Geertz:

“Doing ethnography is like trying to read a manuscript – foreign, faded, full of ellipses, incoherencies, suspicious emendations, and tendentious commentaries, but written not in conventionalised graphs of sound but in transient examples of shaped behaviour.” (Geertz 1973: 9-10)

This was the situation I faced in the Philippines – trying to understand Philippine corporate governance amidst the mix of complex socio-political and economic forces. As pointed out by Gibson & Brown (2009), the research process is rarely linear although there is, like any novel, a beginning, a middle and an end.

I applied some elements of a structure-functionalist ethnographic approach (Angrosino 2007:4) during my field study by interacting with people whom I had previously had little prior contact with. As an outsider, this allowed me to study how the private sector and regulatory organisations were organised. The strong family culture in the Philippines was reflected in the dominance of family-owned business groups and to an extent a substantial part of my results support traditional ethnographic studies of kinship where “family ties are...the ‘glue’ that hold societies together” (Angrosino 2007).

However, mine was not the traditional ethnographic method as I did not observe my interviewees everyday though I saw a select group of interviewees on different occasions, several times, out of the formal interview setting to discuss and explain a broader picture of how the country was run. It was there in the informality of a social setting that they could be more frank and provide the context of how they saw the country, how they lived in the country and conducted their business in the country. Attending other functions by participating in the corporate governance workshops of chambers of commerce meetings allowed me to observe how the business environment worked. Thus, parts of my research support the field-based, inductive and holistic approach of ethnography.

Throughout my results chapters, I have written up case study boxes that contain personalised narratives, observations and descriptions of particular issues and topics that

provide contextual elements of how corporate governance operated in the country. These case study boxes explain extraneous insights of the business environment. These stories are told in realistic, confessional and impressionistic modes (Angrosino 2007: 16) to capture the different elements and events that occurred during my data collection. These boxes are intended to provide an extra layer of understanding. During my time in the field, I also kept a diary as I was also a participant observer. Being in the Philippines, I conducted my research both as a subjective participant and objective observer.

My experience of the research process has been that of trying to ride out the undulating waves of inspiration and thought. During my initial literature review, certain topics appealed and different avenues opened to pursue this archaeological discovery. I began with institutional theories and corporate governance theories of the firm but during my data collection, it became clear that I required more knowledge of the corruption literature which was not a common study in corporate governance research. Re-acquaintance with the literature occurred after my fieldwork as I digested research on business groups, business families, family-owned corporations and, of course, corruption. I also realised that my type of research fell into the economic sociology domain – something that I had hitherto little exposure to, but in the wake of completing my data collection, found affinity with.

Given the preponderance of literature and theoretical perspectives on corporate governance, the top-down theory approach²⁴ worked best in the preliminary design of the study and I initially envisioned my research as a primarily deductive study. However, this deterministic approach changed during my fieldwork as it became clear from the initial data collected (in my early interviews) that the local environment was producing factors that were missing from the corporate governance theories such as the importance government played in determining and influencing corporate governance practice. Coupled with my increasing awareness of the impact corruption had in the country early on in my data collection, a top-down approach on corporate governance research could only be applied to some extent and that if I continued to pursue this approach, my research would overlook these other pressing factors and be poorer for it.

²⁴ Gibson and Brown describe top-down theory as “any theory that has been formulated prior to empirical work, either by other theorists or by the researcher themselves. Theory in this sense may provide a way of posing empirical questions.” (2009:20)

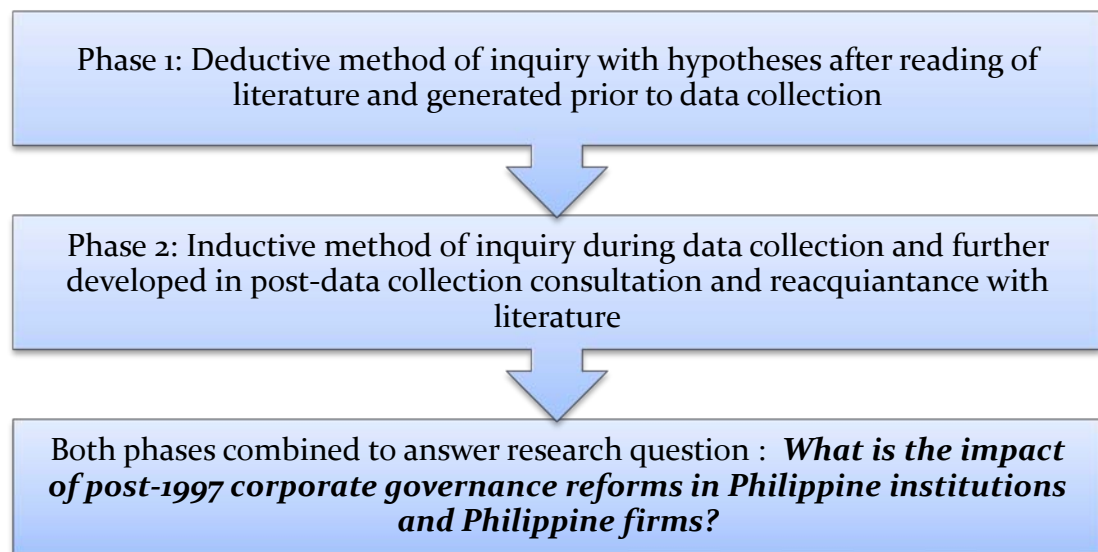
Thus, combining both the deductive and inductive perspective; allowed me as a researcher an appreciation of existing corporate governance perspectives whilst realising its limitations which were going to be supplemented by what I was yet to discover and which I eventually discovered in the inductive phase. Appreciating this combination helped in organising my thought processes of the external factors that affected corporate governance which in my initial reading of the corporate governance literature had not emphasised enough.

In one of the methods I applied – the interview questionnaire - I had open-ended questions that combined the deductive method (which acknowledged prior theoretical contributions) and the inductive method (which allowed my interviewees to articulate how their personal experience of corporate governance) resulting in a better appreciation and more well-rounded explanation of the actual functioning of corporate governance practice in the country.

I also used aspects familiar with the ethnographic research approach in my method and which I applied during my data collection. While I had a questionnaire that set out corporate governance questions, I also made room for other aspects of research collection such as keeping a journal, and collecting newspaper articles that were pertinent to the business environment and corporate governance. In my data analysis, the combination of both inquiries saw the development of several categories that were not in my initial research such as several nodes relating to corruption (see later section on Data Analysis).

Hence my research inquiry can be split into two phases: the deductive which was primarily derived from the theoretical literature review, which generated hypotheses and were tested during the data collection; and the inductive inquiry which allow the data to speak for itself by allowing the exploration of other elements that had an impact on corporate governance reform in the country. The inductive inquiry was present from the data collection phase onwards, and developed further in post-data collection phase when I reacquainted with the literature. Both phases combined to answer the principal research question and the outcome is this thesis. The following flowchart summarises this combined inquiry:

Figure 11: Flowchart Combining Deductive and Inductive Methods of Inquiry



3.5 Hypotheses Development and Testing

Hypotheses development and testing are uncommon in the form of qualitative research I have undertaken. Hypothesis development is a form of theory testing as opposed to theorising – the former is more present in quantitative inquiries, the latter (with the lack of hypothesis development) lends itself to general qualitative inquiries. The use of hypotheses in quantitative analyses generally “[stipulate] a relationship between two or more variables” (Gibson and Brown 2009:139). Sutton and Straw (1995) explain hypotheses are concise statements about what is expected to occur, not why is it expected to occur. Lundberg (1976) elaborates on hypothesis development that requires the researcher to having knowledge of, or acquaintance with the phenomenon/a being a studied, a thorough knowledge of the subject, and an ingrained paradigm.

I had accumulated knowledge and familiarity with corporate governance theories as an employee of a corporate governance research centre so I was acquainted with the theoretical foundations of corporate governance. Indeed, I had developed, generated and formulated my hypotheses prior to data collection in order to guide me and to provide focus on my line of research. I did not construct them during the course of data collection.

Admittedly, in this research I was working from a functionalist/positivist paradigm.

While aspects of my results chapters point to class and elite studies where the Marxist research paradigm might provide further explanation of the existing political balance, such an approach would go beyond the scope of my research and other studies have focused on that (see for example the works by arguably the most well-known and internationally regarded Philippine academic, Walden Bello).

Extending and limiting research has always proven to be contentious and the lesson I have learnt through this research journey is that I can but study a sliver of the phenomenon in order to contribute and further the development of knowledge. In essence, my research was not focused on class struggle but stood in the periphery of it though to live in the country, one was always made conscious of the disparity between the rich and the poor, and I appreciated the context in which my study was occurring.

However my research is primarily concerned with how institutions and organisations reacted to external reforms. In this sense, my paradigm was situated with the functionalists though my approach has been but a cookie-cutter version of it. I believe the combined methods of appreciating both deductive and inductive aspects of research allowed me to study an overall picture of corporate governance in the country. The uneasiness for qualitative researchers to undertake forms of hypotheses development and testing stem from the perspective that qualitative research seeks to further explore the rich, contextual data with the “aim not to think in polarised ways about the relationship between variables, but to interrogate the character and complex inter-relational nature between intricately specified and defined phenomena.” (Gibson & Brown 2009: 139)

In this sense my research follows Glaser & Strauss’ conception of a hypothesis where they regard it as “a way of postulating the relation between different aspects of an analytic framework.” (Gibson & Brown 2009: 139). As I did not seek to build theory but further contribute to existing theory, my hypotheses define “the relationship between two or more features of an analytic framework that can be empirically tested.” (Gibson & Brown: 131).

The hypotheses in this research are as follows:

H1: Post-1997 corporate governance policies in the Philippines will exhibit similar ideas contained in Western principles of corporate governance.

This hypothesis compares corporate governance policies in the Philippines with Western principles of corporate governance such as the OECD principles of corporate governance. This hypothesis is based on finding evidence of institutional isomorphism and aspects of convergence theory interspersed with capitalist varieties of development. Chapter 4 on the Business and Corporate Governance Environment supports this hypothesis with an account of the introduction of corporate governance by co-opting a select group of people in the Philippines, while Chapter 5 on Regulators also provides support for this hypothesis. Results from the hypothesis testing contribute to further theoretical development by giving reasons and accounting for the limitations and usefulness of institutional isomorphism.

H2: Post-1997 corporate governance practices in the Philippines institutions and firms will not diverge from indigenous customs.

This hypothesis recognises that form and substance are two very different things. This hypothesis acknowledges that while the OECD principles are a strong influence, they remain a template and will be shaped by the local environment. Chapters 4 to 7 provide support for this hypothesis, supplemented by evidence from the results of the inductive inquiry in Chapters 8 and 9.

H3: Philippine firms that have adopted Anglo-American corporate governance practices are more likely to exhibit well-defined principal-agent relationships.

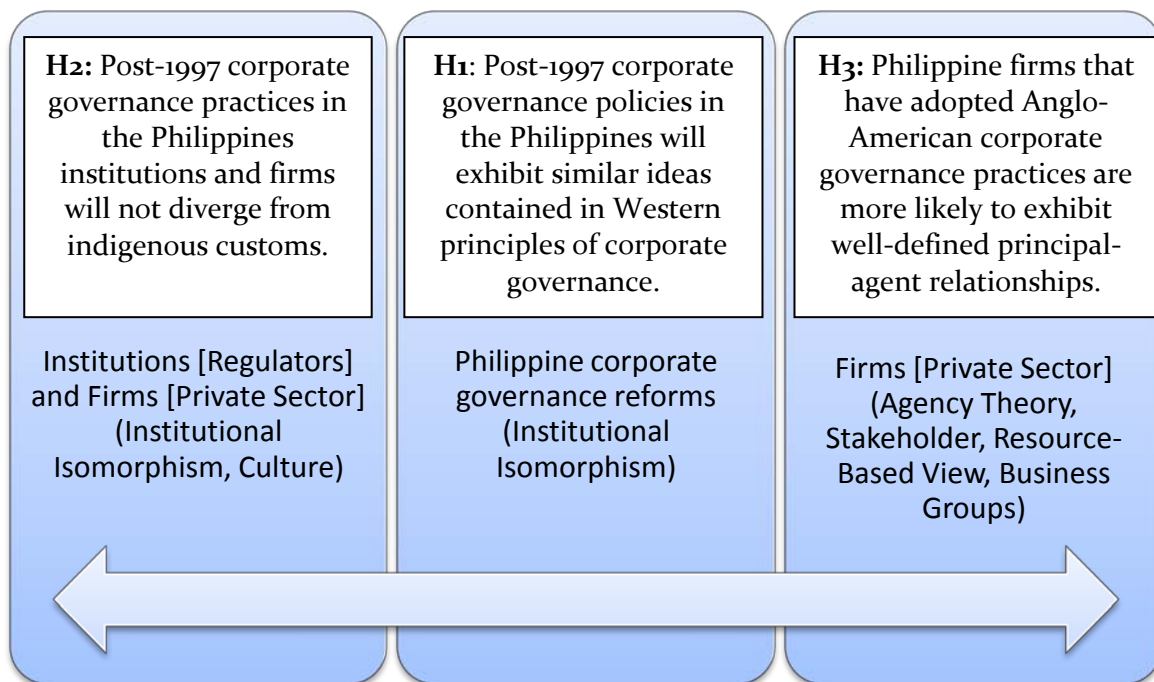
This hypothesis looks at Philippine firms and corporate governance theories of the firm. This hypothesis tries to establish whether separation of ownership and control in the firm has occurred such as the presence of outside directors on the management board and the separation of the CEO and Chairman roles. Given the dominance of agency theory in corporate governance research, this hypothesis is the main test for this theory in this research.

Chapters 6 and 7 clearly shows that this hypothesis was not supported due in large part to the ownership arrangements of a firm. While this hypothesis disproves traditional agency theory, results indicate support for other corporate governance theories of the firm including resource-based view, business groups, stakeholder and the principal-principal branch of agency theory (or agency theory II; see Chapter 2 Agency Theory). In particular, one interview from an independent director in Chapter 7 (whose account is in

a text box) offered firm evidence disproving hypothesis 3. This provides support for Kvale's statement that hypothesis testing can take place within a single interview where "an interviewer's questions test out a subject's concept of an issue" (2007:38). Chapter 8 also provides hints of agency conflict where the principal is the government but due to the politicisation in the country, the agent (being the government bureaucracy or organisation) does not operate independently of the principal (the government or executive/president).

The theoretical framework for the deductive part of my research is as follows in the figure with hypothesis 1 at the centre:

Figure 12: Testing three hypotheses



Corporate governance reforms are at the centre of the research and therefore in the middle column of this figure. Hypothesis 1 (H1) is being tested to find out the similarities in the reforms in the Philippines. The relevant theory for this hypothesis is institutional isomorphism. The impact of corporate governance reforms on the two main units of analyses - institutions and firms - lie on the left and right respectively and H2 and H3 tests the impact of these reforms. H2 and H3 are tested in firms, while only H2 is tested with institutions. H3's relevant theories are corporate governance theories of the firm and business group development. These hypotheses primarily test the form and

substance of corporate governance reforms in the country, a basis from which the inductive part of my research builds upon.

The results chapters prove and disprove these hypotheses and the outcomes are summarised in the following table:

Table 13: The Results Chapters, Relevant Theories, Deductive Hypotheses and Results

Chapter	Title	Theory/ies	Hypothesis	Hypotheses supported?
Chapter 4	Business and Corporate Governance Environment	Culture, Convergence, Varieties of Capitalism	H ₁ , H ₂ and inductive method inquiry	YES to both
Chapter 5	Regulators	Institutional Theory	H ₁ , H ₂ and inductive method inquiry	YES to both
Chapter 6	Business Groups	Agency, Resource-Based View, Business Groups, Principal-Principal	H ₂ ; H ₃ and inductive method inquiry	YES; NO
Chapter 7	Board and Management	Agency and Stakeholder	H ₂ ; H ₃ and inductive method inquiry	YES; NO
Chapter 8	Government Financial Institutions	Politicisation	H ₁ ; H ₂ ; H ₃ (with DBP) and inductive method inquiry	YES; YES; NO
Chapter 9	Corruption	Varieties of Capitalism	No hypothesis testing in this chapter (inductive method results)	

Information on the theoretical oversight of each chapter can be found in Chapter 2: Literature Review.

Chapters 4-8 tested, proved and disproved my hypotheses. Consistently throughout these chapters Hypotheses 1 and 2 were supported while Hypothesis 3 was not.

Hypothesis 3, which dealt with traditional agency theory, unequivocally is not supported in the country. In Chapter 9 there was no hypothesis testing as it was purely the outcome of the inductive part of my research.

Iteratively, my hypotheses form the deductive part of my research and provided a base from which I could explore and conduct the inductive part of my research. The deductive part of my research provided the groundwork while the inductive part of my research

helped me overcome the problem commonly associated with deductive inquiries: that the deductive method is constricting and may “get in the way of discovery.” (Strauss and Corbin 1990: 49)

I did not remain constrained by the straitjacket of choosing one inquiry over the other but allowed both to emerge naturally and serendipitously as the research progressed. I sincerely believe there should be more encouragement to appreciate the use of hypothesis testing for this type of qualitative inquiry where one does not necessarily wish to purely undertake the grounded theoretical approach to research, nor the restrictive quantitative analysis approach more commonly associated in deductive inquiries.

I believe combining both deductive and inductive methods of inquiry has allowed me to produce an extensive account of the impact of corporate governance reforms in the Philippines. While only part of my results has directly been the outcome from my hypothetical testing, they provide, explain and contribute to the theories I have used and cited in this research. Complementing this basis is the glory that is qualitative data in that the text has allowed multifaceted explanations of the phenomenon as a result of the inductive part of my research.

I see the deductive part/hypothesis testing of my research to be at the core and the inductive part of my research explaining the rest of the phenomenon which I had initially overlooked and could not be gained from mere reading of the literature.

3.6 Data Collection

This section looks at the data collection methods that were applied in my research. The following research techniques were used: interviews, document analysis of media articles and other text, and participant observation.

3.6.1 Interviews

Kvale has a fitting metaphor for the interviewer – as a miner who digs and unearths knowledge; and as a traveller – someone who journeys to a faraway land and returns to tell his/her adventures. (2007: 19-20). I’d like to say I was a both a miner and traveller.

Interviews were the primary source of my data collection during my field research in Manila. This method fitted in with the ethnographic approach I applied in my research

as interviewing is “inextricably and unavoidably, historically, politically and contextually bound.” (Fontana & Frey 2005: 695). As Angrosino beautifully describes it, the ethnographic interview is “a kind of partnership in which the informed insider helps the researcher develop the inquiry as it goes along.” (2007: 42)

I conducted a semi-structured open-ended interview as this allowed me to combine both deductive and inductive inquiries – to test my hypotheses whilst exploring, allowing and not restricting the flow of data. Indeed, the interview as a form of “continual hypothesis testing, where interviewer tests hypothesis with the interplay of direct questions, counter-questions, leading questions and probing questions” (Kvale 2007: 86) was a situation I became familiar with over the course of my data collection.

My interview data provides the validity to the phenomenon I observed during my research – it is a collection of people’s experiences and views of corporate governance and personal interaction with my interviewees. My data collection phase does support the structure-functionalist approach that “the data are objectively real; the circumstances in which those data are collected cannot easily be replicated.” (Angrosino 2007:4) Indeed, given the short four months I collected my data, the data does reflect the validity of views on corporate governance in 2007 so the time aspect of the data collection is high. According to Angrosino, undertaking a structure-functionalist ethnographic approach does tend to serve an “inductive rather than a deductive agenda for scientific inquiry.” (2007: 5). Further supporting this approach, throughout my data collection I took the view of trying to be objective by keeping to the interview schedule and interpreting “people’s beliefs and behaviours...as real social facts” (Angrosino 2007: 4). Appendix 1 provides a copy of the questionnaire I used to interview my respondents.

3.6.1.1 Pre-Departure

Despite being born in the Philippines, I have had little connection to my country of birth. Until my research I had no professional or corporate connections in the country. Some thought I could be possibly related to a clan in Cebu given I shared a surname with that business family only to disappoint them. I grew up in Australia and apart from a couple of short trips to visit family and relatives; I had little to do with the Philippines in the last 20 years. As one of the many millions of the Philippine diaspora, focusing my PhD on corporate governance in a country I knew of, but had little intimate knowledge of, was a way for me to satisfy the natural curiosity of one’s heritage.

In gauging the level of research interest for this project, I cold-contacted many organisations in the Philippines usually via email, some via phone or letter, requesting if they were interested in being interviewed for my corporate governance research. Out of all of the organisations I interviewed, I made contact with two organisations whilst in Sydney. One was the regulator, the Philippine Stock Exchange (PSE); and another was from the private sector, the business group Ayala Corporation.

Without the response from these two organisations, I would have had to seriously reconsider the practicalities in undertaking this thesis. I am forever grateful for the response from these two organisations gave to a budding researcher, a stranger from another land, who trusted the electronic means of communications to someone they hadn't seen before nor had knowledge of. The openness and frankness in the email exchange with these organisations established a pre-departure interviewer-interviewee rapport which was reinforced when I arrived in the country and met my interviewees face to face.

For all the trepidation I had that one of the biggest challenges I had would be accessing people and organisations because the country and the culture valued relationships, 'who you know' mattered more, than 'what you know' – connections versus meritocracy – these two organisations showed a level of openness, transparency and disclosure to questions which encouraged this study and my research trip.

By luck, fate or chance, the doubts I had in collecting data in the Philippines vanished. I had at least two organisations I could interview if I went to the Philippines, and they were two organisations that were pivotal in my research and played important roles in the corporate governance environment of the country.

To the Ayala Group and the PSE – your responses encouraged my initial foray and allowed me to expand this into a proper doctoral research. Thank you.

3.6.1.2 Ethical Clearance and Funding of the Field Work

Having established contact with these two organisations, this bolstered my confidence and I duly submitted for ethical clearance from my university (attaching a refined and more formal questionnaire) and applied external funding for my research. The former was an important administrative requirement that strengthened the integrity and conduct of my research while in the Philippines. With an ethical clearance letter

approving my research, I showed this to interviewees and I believe this allayed some of their caution or reticence of talking to a stranger.

As for the latter, under the aegis of the then Department of Education, Science and Technology (DEST), I was awarded an Endeavour Research Fellowship²⁵ from the Australian Government which funded all aspects of my fieldwork including collection of my data for my study in the Philippines for 4 months from May to September in 2007. The funding covered all my living expenses whilst in the Philippines and I highly recommend this program to prospective research students. During my stay in the country, I was affiliated as a visiting researcher at the Institute of Philippine Culture at the Ateneo de Manila University.²⁶

3.6.1.3 Collecting the Sample In-Situ

It is often said that the most exciting stage of a qualitative research is collecting the data. It was with a combination of adrenaline rush, enthusiasm and motivation that marked my stay in the Philippines. My aim was to interview representatives from Philippine companies and regulatory institutions. Hence, I brought with me to Manila several level arch folders. I decided that listed companies would be the best start to contact. I printed off the 200 or so entries from the Philippine Stock Exchange website. I also had to ensure that some of the listed companies who were owned by the same business group were not contacted, but instead contacted their holding company. As the mother company, an interview with the holding company would best give the overall picture of the situation of the business group, rather than each listed operational company. I also printed non-listed, non-company organisational websites to interview.

I divided the folders thus: companies and organisations I've contacted, companies who agreed to be interviewed, companies and organisations who have not responded, and companies and organisations who did not wish to be interviewed. The correspondence with the select few who agreed to be interviewed was kept in a separate folder.

Contact was usually done via email or by phone. Some were quite blunt and said no, some did not respond, some email addresses did not work, and a few said yes. Over the

²⁵ With the change of Federal Government in 2007, DEST was transformed into the Department of Education, Employment, and Workplace Relations (DEEWR) which oversees the fellowship http://www.endeavour.deewr.gov.au/Australian_applicants/research_fellowships.htm accessed 25 May 2010

²⁶ Institute of Philippine Culture <http://www.ipc-ateneo.org/> accessed 25 May 2010

phone, some companies did not know who to transfer my query to, and some companies did not want to talk at all and gave a response that was long-winding but a particular cultural aspect of the Filipino version of making a polite refusal without actually saying no (which have been mostly ascribed to Japanese culture but is probably indicative of the East Asian region in general).

3.1.6.4 Interviewees

For those companies/organisations and their representatives (all senior management executives and/or board members) who did agree to be interviewed, the interviewees were done face-to-face that lasted at a minimum, an hour long to three hours while a few wanted the interview to be conducted by email due to reasons of geography and time. Overall, 40 interviews were conducted with 60 representatives. Most face-to-face interviewees were conducted with one or two present. In one particular case, I had a lunchtime interview conducted with 9 representatives from one organisation and this was my one sample of a focus group type of interview. I gave my business card as an introduction though unlike other countries in Asia, exchanges of business cards are not a formal ceremony in the Philippines.

Conscious that I was a stranger to them and that I had only a short time to establish rapport, trust and confidence, I intentionally did not use a recording device and instead relied on pens and notebooks. Indeed, one interviewee was so surprised by this that he did not believe me at first and looked me up and down for the recording device before finally asking if my pen was the device. Having obtained access and permission to interview them, I did not want to risk jeopardising an interview by obtaining an extra permission to record them in audio/video form and have them not be as frank or as open. Even if I lost parts of the data for not having a full audio record, I believe, accessing my sample of interviewees as I have done is sufficient achievement for me.

My decision to have an ordinary pen and paper and not an audio recorder of the interview (unless it was conducted by email) was supported every time an interviewee mentioned that he would like to go off the record and I had to put my pen down and just listen to him (no female interviewee ever wanted to go off the record). Several interviewees also cautioned me that what they were saying were sensitive information and I was made very conscious of their reason for doing so. Bound by my ethical obligations as a researcher which is to firstly protect the interviewee, the data from my

interviewees in the results chapters – unless they gave me specific information for their person/organisation to be known – have been de-identified and are anonymous.

To thank them for their time and generosity, I gave each interviewee a token pen. Given the ethical issues that I discussed (such as bribery, undue influence etc), the token pen gesture became a source of post-interview discussion with some of my interviewees on its propriety and whether one should declare the pen as a gift to their organisation. In the interests of disclosure, each pen cost the nominal amount of AU\$5.

After the interview, I typed up my interview notes the same day to ensure the data was still fresh in my mind. Overall, an interview transcript was an average 12 pages long (1.5 space, A4 size) with the shortest being 8 pages and the longest being 22 pages.

If there were further queries that emanated from the interview, further contact was achieved through email, phone or mobile phone texting. The last method was a particularistic Philippine cultural trait as mobile texting was heavily used in the country given the country's lack of landline access and reliability of internet connection.

The organisations that are listed in Appendix 2 are supportive of, and at the vanguard of, promoting corporate governance practices in the country. This research would not have been possible without them and I am forever grateful for their generosity and magnanimity in allowing this researcher access to them and their knowledge.

3.1.6.5 The Art of Networking

Networking was important for me in interviewing people and trying to immerse myself in the culture. Given the limited amount of time I had in the country, I threw myself into attending events, functions, workshops and other gatherings where I could meet and interview people. This developed my skills in the art of the small talk and meeting with different people from various backgrounds - a skill underemphasised in books that advise how to do qualitative interviews. By luck, chance, and sheer forwardness on my part, my philosophy in approaching people to interview was: "the worst they could say was turn me down and say no. I have nothing to lose." For four months in Manila, it was *carpe diem*. In attending corporate functions such as dinners and chambers of commerce, I approached strangers directly without waiting to be introduced – which in most countries, as in the Philippines, is not the norm and a noticeable social faux pas. Some of my victims were curious, some were totally defensive and gave a flat out no, and

the few who assented were one of the best interviews I conducted. A list of events and gathering I attended during the course of my stay in the Philippines is in Appendix 3.

3.1.6.6 The Informal Setting

As previously mentioned, for a select group of interviewees, I also managed to meet them outside the interview setting which allowed them to discuss with me issues that they did not wish to have on record during the interviews. The less formal meeting and off-the-record conversations provided the context and justification of their comments in the formal interview. In particular, these meetings allowed them to be more expansive on how they saw business being conducted in the country and explain other sensitive issues which they did not wish to have on record but which gave me an insight. The results chapters bear this out. In a way, my most controversial chapter in this thesis, Chapter 9 on Corruption, was the outcome of conversations I've had in informal settings. In formal settings, corruption was alluded to with veiled suggestions on where government may improve its record in this regard; in informal settings, countless stories and experience of corruption were told. In some circumstances, I did feel the latter became a therapeutic session for some interviewees. Telling an outsider the way of doing business in the country was a way for them to unburden about their own internal conflicts and difficulties, and feelings of frustration and sadness. The people I interviewed were in positions of power and influence, yet they felt this overwhelming sense of impotence and limitation in altering the dynamics of the country, and making a difference to reduce the poverty in the country.

My experience of the informal setting provides support for what other researchers have found: that what is said off-the-record is as important - if not more - than on-the-record interviews.

3.1.6.7 Foreign Companies

Despite attending numerous foreign chambers of commerce events in essence to network with their representatives, I couldn't increase the interview sample of foreign companies. By email I entered into long correspondences with companies based in Asia-Pacific regional HQs in Hong Kong, only in the end for them to say "No, at this stage we will not allow you to interview us." With one email interview I conducted with a foreign subsidiary, there were numerous people cc'ed in the email message including several lawyers. Needless to say, the responses were not as rich as a face-to-face interview, heavily screened and diluted as it was going to be publicly available data. In response to

my question on recommendations to government, the answer was a simple no. Out of all my interviews, this was probably the question that elicited the most frank response, yet behind the corporate communications, this foreign subsidiary, perhaps out of self-preservation and not to invoke host government scrutiny was quite bland. Feelings of disappointment were a natural effect. I can only say for foreign businesses that do business in the Philippines, they take a high risk and veer into that grey part of business conduct that may not be well looked upon in their home countries.

3.1.6.8 Why am I doing this research on the Philippines?

Only one interviewee probed me further for reasons why I was researching corporate governance in the Philippines. Responses that my natural curiosity and the fact that I worked for a corporate governance research centre was not a satisfactory answer. From my perspective, my agenda was to complete my thesis and doing it on the Philippines was a natural fit. This was the self-serving element of doing research on the country of my birth. Having watched others go through the arduous task of undertaking their own PhD research journeys, one of the main personal challenges in completing a thesis is motivation and how to sustain the motivation through this solitary journey. As most PhD students would empathise, one starts off a PhD hoping to change the world. Upon completion, it is not the world that has changed, but rather the PhD has changed the student. I knew that out of obligation to my heritage, I would complete this thesis. That was and remained the strong motivation in completing this thesis.

Below are my observations notes from that interview conducted with two people:

“[The] company [is widely recognised as having] the best corporate governance practice in the Philippines. [Interviewee A] was curious about my research – why I was doing it. I made an introduction on why I was involved in corporate governance. Post-interview he asked again and I responded the personal (diaspora) and professional (researcher) reasons. I guess he found it unusual why I, who had little connection with the Philippines, was doing the research but I saw this was an impartial research on my part.

“[Interviewee A] left [the company] to join [a government authority] then rejoined [the company]. He had planned to reform the [authority] and abolish it and replace with another but was unsuccessful. [He knows] this academic whom I met earlier.

“[Interviewee B] used to work for the World Bank and we exchanged stories about a [mutual contact]. [Interviewee A] had posters of corporate governance initiatives that his company has done on his office walls. His business card even has a box called “Corporate Governance: It begins with me”. [Interviewee A] seemed very serious and distant throughout most of the interview. [Interviewee B] was friendly on the other hand.” – May 2007 interview observation notes

I guess I would have made an unusual sight going around Manila doing my interviews, cold-calling companies asking to talk about the processes of their company to a stranger. In hindsight, I suppose the reluctance to open up to me was probably a big element of companies that refused to be interviewed by me: the face value element. Conflicts of interests, hidden agendas, opacity – doing business in the Philippines is difficult. For this particular researcher, the particular challenges of the country provided a fertile ground for collecting data.

Another interviewee even had me followed because he didn’t trust the business card I gave him as he told me I could have made up my identity. Piracy is common and pirated business cards are not unusual. Understanding this environment allowed this researcher to adjust to, and empathise even with the paranoid tendencies of this particular interviewee. Indeed, Intel CEO Andy Grove wrote a book entitled *Only the Paranoid Survive*.²⁷

In the Philippines, trust is an important element. Who to trust and whom not to trust is important in this environment; I can only say this was some of the hazards or the more unusual aspects of collecting data in a developing country.

3.1.6.9 Access

In general, obtaining access is a key problem when conducting “elite studies” (Neuman 1997: 336-339) or interviews “with persons who are leaders or experts in a community, people who are usually in powerful positions.” (Kvale 2007: 38) I am pleased to say that this problem was dispelled quite early in the field work. My interview observations notes bear out my way of accessing interviewees and effectively swept away notions of “lack of access” especially my pre-departure notions that I may be unable to access Filipino-Chinese business families.

²⁷Grove, Andrew S. (1996) *Only the Paranoid Survive*,
<http://www.intel.com/pressroom/kits/bios/grove/paranoid.htm> accessed 9 October 2009

So for the much-maligned apprehension of the potential reluctance of Chinese Filipinos to talk about their corporate governance experience, I am pleased to say, apart from the exceptions mentioned in the next section, this was not an obstacle in my research journey. I do not believe that non-participants would have contributed anything more significant had they agreed to an interview than those who did. A reluctant interviewee is not a rich source of data and I appreciate the openness of most of my interviewees for it is in these pages their stories are related.

Below are two of my interview observation notes that provide an insight into accessing my interviews (by luck or opportunity), how the business elite live, how the referral system worked, the geopolitical environment of the country, how the country's situation has affected families and the candidness of the response of some of my more open interviews:

"[Interviewee #1] is a well-connected man (especially I believe in the Filipino Chinese community). He was referred to me from [a previous interview]. An Opus Dei member, [he] was part of [a government authority] created for privatisation. He was also a board member of [a conglomerate] during the [former owner's] days. He said he was an independent director on the board and was considered the black sheep of the board.

"He also referred me to [a regulator]. He is also good friends with some of the PSE players. He introduced me [to this] CEO/Chairman of [a listed company] whom I later interviewed. He is in most cases on a first name basis with the business community in the Philippines. Again, a well connected man although the diaspora has affected him as well. His parents live in the USA and so do his kids. One of his close friends is [a bank] CEO. [He] said his wife was from the old Spanish Filipino families.

"After I told him a story about [a contact's] connection to the Gandhis about a coup attempt on an island archipelago, and ringing Rajiv Gandhi to send in paratroopers, he said to me "you will hear a lot of stories about the Philippines" –
July 2007 interview #1 observation notes

After my interview with Interviewee #1, he accompanied me to the first half of my interview with Interviewee #2. I wrote the following notes:

“[Interviewee #1] accompanied me to [Interviewee #2], a good friend of his. It became more of a reunion between two friends and I was just an extra. Both being of Filipino-Chinese backgrounds, [Interviewee #2] looked at me and said “I don’t know you but [Interviewee #1] I have known for 30 years but that’s how Chinese relationships work so ask away”. [Interviewee #2] also at length showed off a present – a coffee table book created by his daughter who lives in the USA. He said: “Even Manny Pangilinan” (CEO of PLDT) doesn’t have one!

“An affable man, the interview went jolly well. He offered me some *espasol*. He had recently joined [this company] and knew [a business family I interviewed], he said the family wants to keep control as I suggested – cheekily on my part - a synergy between the two companies. He is an American citizen having lived in the USA for awhile however he wanted to return to the Philippines for patriotic reasons.

“During the interview – haphazardly done due to the reunion between [Interviewees #1 and #2] – was President Arroyo’s State of Nation Address (SONA) TV coverage. [Interviewee #2] would at various points show me [which politicians] he knows. He also said that he had stopped banging his head against the wall and that if he entered politics he would be assassinated. He said at his age he would rather just do what he will be able to do what and when he can. One of his executives was watching the SONA waiting for GMA to mention their project in Mindanao. But this was never mentioned. At one stage [Interviewee #2] showed me and [Interviewee #1] a map of Mindanao and said why Basilan is such a big problem is because the peninsula facing Basilan is shaped like a penis so Basilan is being pissed on.” – July 2007 interviewee #2 observation notes

Business research in Asia has emphasised much on the ethnicity of the family with many studies on Chinese business networks in the region (Weidenbaum 1996, Hamilton 1996). However, what unites all business families is the common goal of commerce. Facilitating commerce is part and parcel of trade and globalisation. What matters more in commerce is the regulatory frameworks, the rule of law, relations with government and less on the ethnic origin. A good idea and product in the marketplace counts more than the ethnic origins of the entrepreneur or facilitator. At least for this researcher, ethnicity was not an

issue in terms of access. My sample was enriched by participation from big and small businesses owned by Filipino-Filipino, Filipino-Spanish and Filipino-Chinese.

3.1.6.10 Snowball Effect – The Referral System

It was clear that being in the country had a more positive effect on collecting data than outside it. The glorious referral system of who you knew in Manila counted. Again as Neuman pointed out:

“Elites will use who you know, who talked to you, and who introduced whom as sign of approval or endorsement.” (1997: 338)

This occurred more towards the latter stages of my data collection. I experienced the snowball effect – or the referral system. One would refer me to his or her network – the ‘who you know’ came into play.

I expected barriers in data and contact, but instead I saw how connections and networking worked. Who you know counted more. People who lived and worked overseas had a particular advantage working in the Philippines. Similar to other cities around the world, those who have had international exposure have a macro and cosmopolitan view of the world. The interviewees who were referred to me were articulate, intelligent and exceptionally knowledgeable.

Far from parochial, the interviewees I made contact with were global, broadminded and mindful of the many business opportunities that await the country if only, and in parallel, the government could loosen its grip and reduce the existing inefficiencies and create a level playing field by removing barriers to entry, reducing protectionism in the country and allowing competition, reducing bureaucracy and vanquish the poison that is corruption.

3.1.6.11 Notable Non-Interviewees

It is worth mentioning that despite my general success, I also failed to access several notable business groups. There are two notable business groups missing from my interviewee sample. Both are headed by Chinese-Filipino taipans who have cultivated their business through the unpredictable nature of Philippine politics. Their success seems to wax and wane depending on whether the presidential administration is a supporter or opponent. One is Lucio Tan, the other is Eduardo Cojuangco Jr.

3.1.6.11.1 Lucio Tan

Lucio Tan came to prominence as one of Marcos' cronies (Hutchcroft 1998: 133, 237) and the survival of his business interests after the dictator's fall is testament to his endurance and remarkable luck – this view dependent on which side of the fence you sit on.

Perhaps it was wise (on both sides) that an interview did not proceed. Indeed, whilst collecting my data in Manila, the son of the former dictator, Ferdinand 'Bong-Bong' Marcos Jr. reminded Tan of his recent past with attempts to reclaim expropriated assets (supposedly owned by the Marcos Family) from Tan. (Magno 2007, Sy & Mendez 2007, Business World 2007b)

A newspaper editorial pointed out this irony:

“The President Commission on Good Government (PCGG) is seeking the forfeiture of some 60% of Tan's shareholdings in 10 giant companies – among them Fortune Tobacco, Asia Brewery and Allied Banking – claiming that the Chinese Filipino businessman merely served as a dummy for the late dictator, Ferdinand Marcos, who was their real owner. Tan, who is now estimated to be worth US\$2.3B, was reputed to be one of Mr. Marcos' closets cronies. In a surprising turn of events, the Marcoses announced they were going to testify against Tan.”- Philippine Daily Inquirer (2007)

I did not manage to speak to anyone from Mr Tan's companies despite several attempts by phone. However, the owner was present in some of my interviewees' thoughts as the following sample show. These thoughts ranged broadly from the critical:

“He was once heard to say: ‘If you bring me a big foreign company to do business here in the Philippines, I will be able to shred that company to bits. No global foreign company can compete against me here in the Philippines. No competition at all. But if I go to the USA, and do business there the way I do business here, I would not last a day.’” –private sector 1

“A lot of companies here don't practice accountability and transparency. The SEC and PSE need to have the resources to enforce stricter rules. [Tan] does not have a reputation for practising good corporate governance” –private sector 2

“The policy I was espousing he disagreed with, so I had to go because the President needed his support.” – Chinese Filipino private sector interviewee

To the more philosophical:

“There are big names in politics forming alliances with the private sector. Under Marcos there were alliances with his cronies who became the new elites: Tan, Siotan, Cojuangco.” – private sector interviewee 3

Tan’s influence and interests span and bridge the business and political fabric of the country and he is a figure whom one cannot have an ambivalent position on. However, like his peers, he currently faces the same succession challenges as he prepares to hand over his portfolio of interests to the next generation.

3.1.6.11.2 Eduardo Cojuangco Jr.

The other tycoon worthy of a mention is Eduardo Cojuangco Jr. Eduardo Cojuangco Jr. comes from a prominent family and cousin to the late president and adversary, Corazon Aquino. He was part of Marcos’ coterie also known as the “Rolex Gang” as the dictator was reputed to give his closest supporters a Rolex watch. During the turbulent period of the Estrada presidential administration, of which he was a close ally, an apocryphal tale had him march into the boardroom of San Miguel Corporation (SMC) demanding the CEO and chairmanship. San Miguel Corporation produces San Miguel Beer - perhaps the most prominent and recognised Philippine brand in the world. The corporate history is nothing short of a Shakespearean drama. (Conde 2005)

Boardroom battles and Cojuangco Jr. seem to be linked and in 2009, SMC took control of Petron (Sanchez-Lacson 2009) and a tussle for the control of Meralco pitted him against the Lopez Family reminiscent of the dark days of Marcos.²⁸

Cojuangco Jr. has a strong Australian presence with former interests in the Australian dairy and horseracing industries. Given his Australian connections (Askew 2005), I thought I would receive at least a response. A letter sent to their Melbourne headquarters when they still owned the Australian dairy entity National Foods²⁹ (before

²⁸ The battle for representation on the Meralco board occurred with GSIS and SMC on one side, and PLDT and the Lopez family on the other. PLDT under Pangilinan is said to be the Lopez’s white knight as there were moves by SMC to take over Meralco. See Lucas (2009) and Rimando & Balea (2009)

²⁹ In April 2009 in an informal conversation, a National Foods executive imparted the offer price by Japanese company Kirin as the main motivation in divesting this asset and not because of greater corporate governance scrutiny. He also said National Foods under San Miguel was operating heavily under the direction of two significant shareholders and the then owners didn’t believe in practicing good corporate governance. The switch for National Foods from being

selling it to Japan's Kirin Brewery) went unanswered; emails and phone calls to San Miguel Corporation in-situ were also unsuccessful. Although to give due credit, I decided not to pursue the avenue to interview a pension fund owned and controlled by his group as I was nearing the end of my research trip.

3.1.11.6.3 Other Elusive Interviewees

Other interviewees missing from my sample include those who have had incidences in their past that have stained them in the capital markets. These incidences include parent company-subsidary relationships and less than timely disclosure. The capital markets can be quite unforgiving when it comes to such 'stains' and punish severely those that do not practice timely disclosure.

3.1.11.6.4 The Final Interviewees

Towards the latter stages of my time in the field, I was hearing similar information. I had interviewed a wide variety of people, various stakeholders and the data was overlapping. I had reached what is commonly known as theoretical saturation (Strauss and Corbin 1998: 292-293). The data collection of my research had reached its natural conclusion. I was not uncovering new information or significant variation of perspectives anymore and given the limited amount of time I had in the country, my researcher's instinct suggested that the interview data I had gathered was sufficient. I knew I had to stop and so chose someone in a prominent position for my final interviewee. It was a good way to book-end collecting the interview data sample.

3.6.2 Media Articles and Other Text

Supplementing my interview data were my secondary sources of data: media articles and other text. Like interviews, documentary research is heavily used in qualitative research (Silverman 2006) as they are "a ubiquitous feature of social life." (Gibson & Brown 2009: 65).

While in Manila, I collected newspaper clippings or media articles I deemed relevant and related to my research. Over the four months, I became rather methodical and formed a habit of reading the daily broadsheets then cutting out and pasting in the most useful in

Filipino-owned to Japanese-owned drastically saw different corporate governance practices from one where there was without to one where there is now a form of Japanese corporate governance in place. I also explained my unsuccessful attempts in accessing an interview, and the executive responded I'd have probably needed to get a referral from Austrade and pay for the privilege of interviewing a principal.

my scrapbooks. For my newspaper articles, a total of 892 articles were collected and they were coded in NVivo (see Data Analysis). The bulk of these articles were collected between June 1, 2007 and 31 August 2007. The articles were hard copy versions from the main Manila newspapers eventually reaching two volumes which I carried back with me to Sydney. After my in-country field trip, some articles were collected afterwards in light of geopolitical issues in the Philippines and these articles were saved electronically.

A list of media articles I collected and analysed is in Appendix 4. Supplementing the media articles were other texts given to me such as company annual reports, copies of emails and related organisational documents.

3.6.3 Participant Observation

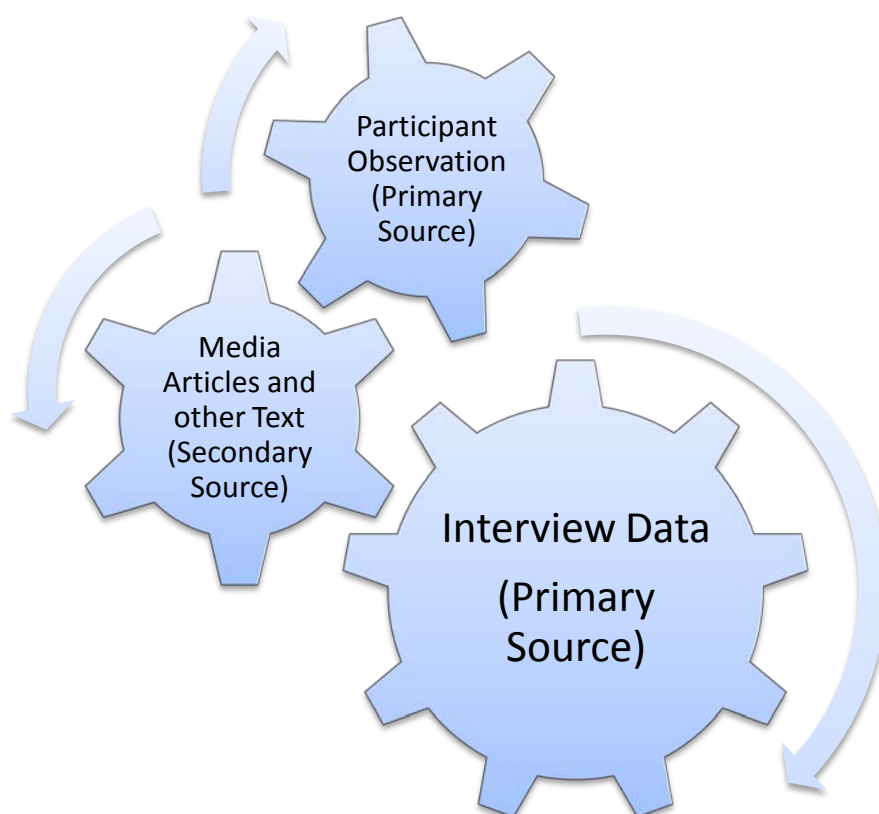
Finally, the last technique I used was me as a participant-observer. This technique is not a research method but rather “a strategy that facilitates data collection in the field.” (Bernard 1988: 150). Concurring with Angrosino’s (2007) sentiment on the participant observation technique, I conducted my research both as a subjective participant and objective observer.

I kept a diary during my stay and wrote structured pre and post-interview observation notes as previous sections in this chapter attest to. With each face-to-face interview I had a preamble which described the circumstance of the interview (e.g. how was s/he accessed), my observations of the venue (which does reflect the resources an organisation had, see in particular Chapter 5 on Regulators where I compared and contrasted the building of one regulator to another), the time and length an interview took (brief, comprehensive), the behaviour of my interviewees during the interview (open, closed, comfortable, uncomfortable defensive, encouraging etc) and my own feelings as a researcher after an interview (elation, disappointment, able to establish a rapport with the interviewee or not).

Throughout my results chapters, there are case study boxes that contain personalised narratives of particular issues and topics that provide contextual elements of how corporate governance operated in the country. These case study boxes are extensive stories that try to explain extraneous insights of the business environment. These stories are told in realistic, confessional and impressionistic modes (Angrosino 2007: 16) to capture the different elements and events that occurred during my data collection. They

are principally the outcomes of the participant observation process. The following figure is a visual representation of how I saw these three sources of data working together to support my chosen methodology:

Figure 13: Three Sources of Data - The Qualitative Triangulated Method in Gear Motion



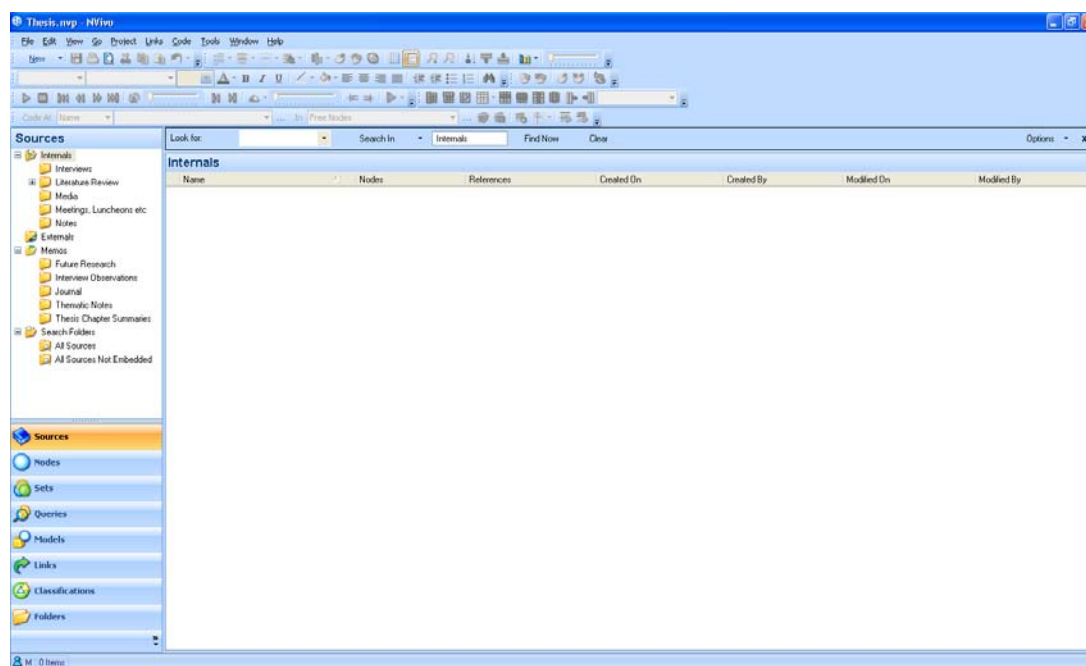
3.7 Data Analysis

In managing, organising and analysing my interview, media and other text data, I used a computer program called NVivo. I attended two workshops on NVivo funded by the Research office of the UTS Faculty of Business to learn how to use the program. As I was working from an ethnographic approach, I principally used the program in a code and retrieve manner though the program has features that extend to include building sophisticated models and conceptual networks. Gibbs (2002) and Bazeley (2007) provide a comprehensive account of working with the program.

I customised the folders in NVivo under Sources (on the left hand side) by creating categories of Interviews, Literature Review, Media, Meetings and Notes. Documents

under this folder were coded line by line. Under Memo, I added folders on Future Research, Interview Observations, Journal, Thematic Notes and Thesis Chapter Summaries. They form supplementary information and I did not code them but referred to them and created notes to jot down ideas as I was coding the main Sources documents. The following screenshot shows the main page of NVivo:

Exhibit 1: Screenshot of NVivo program



My approach in the data analysis of my interview and text data was I had a more bottom-up approach in exploring the data. What I found useful in the NVivo was the ability to create nodes. “Nodes are containers to hold ideas, and represent concepts or categories” (Madden 2008: 16) and they were invaluable in my research. My node-heavy coding allowed me to structure my results chapters in a way that I never thought possible prior to my data analysis stage. My use of nodes heavily influenced how each results chapter was structured and my subheadings in each chapter are a reflection of my node use.

I did not create ‘a priori’ nodes though I was guided by overarching themes in my data. I initially thought I’d take the top-bottom up approach and create several nodes in which to code but realised early on that this way of coding did not suit my work style. The inductive inquiry extended into the data analysis. As I analysed each line and passage of text, I allowed several definitions and perspectives for the data which again, finds more affinity in the grounded theoretical approach of qualitative analysis (Charmaz 2006).

However, I did not lose sight of my initial research themes nor my hypotheses (with the exception of the chapter on Corruption which was definitely the serendipitous aspect of the research) and the use of NVivo allows the combination of both deductive and inductive approach to qualitative data analysis.

3.7.1 Node Saturation in NVivo

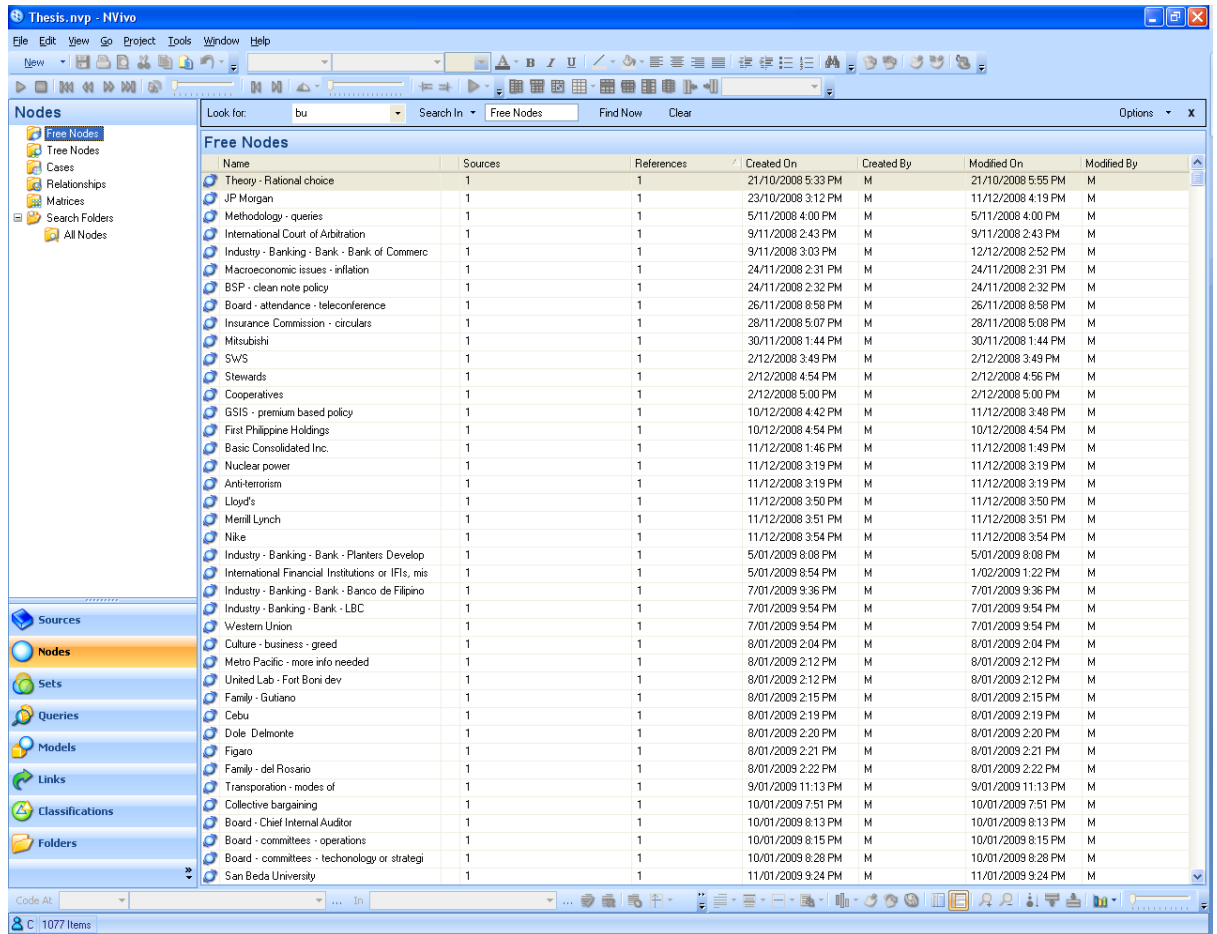
As I had combined inductive and deductive methods of inquiry, the latter had given me a useful list of concepts that was already present to test my hypotheses and therefore code my data as appropriate. I was “bringing a strong theoretical basis” to my research and as Bazeley suggests, in this form of “*a priori* or theoretically derived codes”, a researcher using NVivo generally ought to:

”analyse your research question and identify from within it every category or concept that is used, knowing that you will need a node for each concept in order to gather (and then relate) data about them.” - (2007:76)

Indeed, most of the text fell in clearly defined ideas that were generated from my hypotheses. However, I did not allow myself to be restricted in my reading of the text. I did not have the problem that Bazeley chides deductivists of having as I did not restrict myself or “confine” my reading of the text. Instead, I allowed further interpretations of the data thus generating further development of ideas that went beyond the boundaries of my initial research inquiry but which substantiated it. My results chapters are testimony to this form of combined analysis. It is important that hypotheses be tested, and see their further contribution to theory. However, beyond hypotheses testing, my research took advantage of the strength of inductive qualitative inquiry by contributing a more expansive perspective and giving into context my deductive results.

Where grounded theory emphasises “theory work should continue until data saturation has been achieved” (Gibson & Brown 2009: 27), my approach to the NVivo qualitative data analysis was to saturate each passage of text to the point where I reached “node saturation”. I coded every line from my interviews whereby after I had coded all my primary text, I had categorised to 1077 items. The following historical screenshot shows the nodes that only had one reference and one source which I soon merged with other nodes:

Exhibit 2: Screenshot of Nodes Prior to Amalgamation



After amalgamation and merging of some nodes that had a singular reference and deletion of some duplication, I had managed to bring it down to 972 working nodes.

In my data analysis, node saturation for me was where every possible theme or category attributed to a statement or sentence was coded. Thus for one line, it was possible to several nodes attached to it. For example, one line of an interview where there were political overtones made by a private included nodes related to the political environment, the situation of the firm, the structure of the firm, relationship with the government and several others. This is a form of “fracturing or slicing data” where the multiplicity “capture what is happening in a single passage of text” (Bazeley 2007: 71)

An example of what I mean by node saturation is the coding I have undertaken in this poignant passage of raw interview data below which I have captured and enlarged as a screenshot from NVivo in the following exhibit on the next page:

The screenshot is divided into three columns – the left hand side shows the Folders of Sources and Memos containing other documents; the middle shows the raw interview data; the right hand side shows the coding stripes that contained the nodes in the interview. The interviewee wishes for anonymity hence this document is entitled Anon. This passage contains a moment in the interview when off-the-record data was made. Prior to that, the interviewer was explaining the business' relationship with the government which veered into a macroeconomic narrative of the political environment in the country. Text in bold was done by me to emphasise and indicate the importance of that particular data.

In this particular passage, the text was coded to the several nodes (indicated by the coloured stripes) principally to the top level nodes of Presidential appointments and Corruption. Just in the right hand column where the nodes appear, is a strip of line called "Coding Density". It shows how heavily the passage was coded to nodes – the thicker the line, the more nodes it had been coded to. For this particular sentence:

"The government is corrupt from top-to-to bottom. Change the constitution, change culture. You can't get anything done here; it's all done by facilitation."

hovering my mouse over the coding density, a textbox appears which shows this text was coded to 18 nodes principally to Asian corporate governance, Business strategy, Competition, Corruption (and secondary or sub-category level headings), Culture, Government, Legislation and Political Environment. Apart from trying to objectively analyse this passage, the other side is this passage - like so many other texts in my interview data - did have a profound effect on me as a researcher. During my research stay in the Philippines I frequently emailed my supervisor about the distress I felt and unburdening the frustration my interviewees felt about how the country operated. Undoubtedly the use of NVivo tries to depersonalise the elements that may intrude or 'emotionalise' the integrity of the data but I did want to briefly mention that I wanted to be objective as possible but the compounding effect of such interview text did have an effect on me as a person.

3.7.2 Most Common Nodes

The 25 most common nodes I had referenced to after taking into account all sources are set out in the following table:

Table 14: Most Common Nodes Used in NVivo Data Analysis

Rank	Node	References	Sources
1	Business groups – family	175	44
2	Company-family relationships conflict	158	42
3	Corporate governance – awareness	145	48
4	Culture – business – family	142	45
5	Private sector reform and development	129	53
6	Theory – Business Groups – Family Businesses	122	32
7	Investors – foreign	188	48
8	Political environment – uncertainty	113	46
9	Board – Director – Independent – opinion, perception of	112	37
10	Corporate governance – applicability of	109	43
11	Family business	108	36
12	Corporate governance reforms	102	36
13	Corporate governance – perception	100	38
14	Board – Director – Independent – concept of	100	34
15	Corporate governance – regulators	100	38
16	Board – members	98	37
17	Corporate governance as practice / pragmatism	98	40
18	Corporate governance as compliance	95	37
19	Culture – business – closed or insider	94	34
20	Securities and Exchange Commission (SEC)	93	35
21	Industry – banking	90	31
22	Ownership and control – listing – family	88	19
23	Culture – business – boards	88	32
24	East Asian Region including Free Trade Areas (APEC, ASEAN)	87	37
25	Corporate governance – transparency	87	38

In this table, references refer to how many times a body of text was coded to a node while the source refers to the aggregate number of interviews, articles and other related papers that were part of my data analysis. For example, with the most common node of “Business groups – family”, I had referenced it 175 times throughout 44 sources or documents.

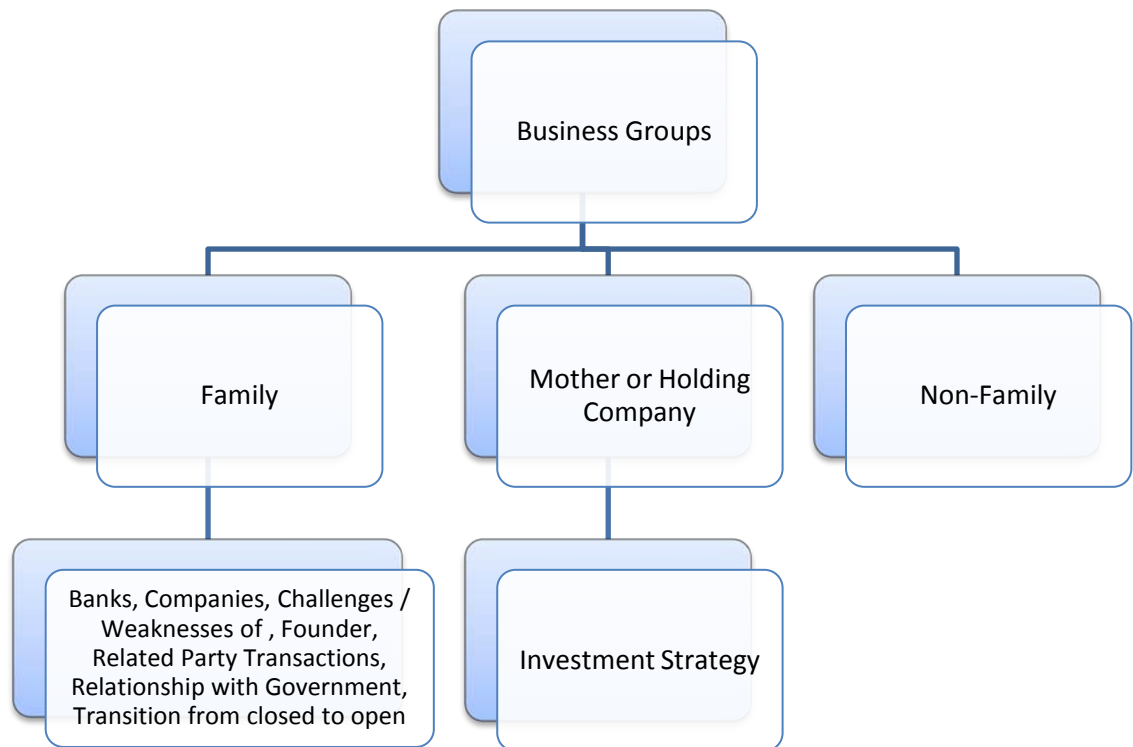
Additionally, I did not make much use of the tree (or hierarchical) function in NVivo as I

found it made the search function much more time consuming personally. To find a solution for this, I created free nodes with hierarchies by having a dash or '-' attached to a main node to denote a sub-category or a sub-sub-category.

Thus with the node “Business groups – family”, “Business groups” is the main tree/node or category with branches or subcategories forming from it such as “family”, “non-family”. Thus I created a primary level, then a sub-category level, and a sub-sub-category level.

Below is a tree diagram of the “Business groups” node as an umbrella term encompassing all its sub-sets.

Figure 14: Main Node of Business Groups and its sub-sets



Thus, under the “Business Groups” node, the sub-category of “Family” had a third level which included that encompassed “Banks”, “Companies”, “Challenges / Weaknesses of”, “Founder”, “Related Party Transactions”, “Relationship with Government”, and “Transition from closed to open.”

Having this form of noding also allowed me to structure each of my results chapters as befitted a main node. Thus for Chapter 6, elements of how I categorised a main node is

present in how the chapter was written as that chapter is largely structured around the owners of Philippine companies which were mostly business groups.

Naturally, there were some overlaps as language and meaning can be interpreted differently as I found out in trying to node business family related issues. Hence, in the table showing the top 25 nodes, there are 6 nodes that have the word 'family' attached to them, yet I had defined them differently when I created each one. Below is the table containing these six nodes with definitions (and how they were refined over time, for example I sometimes provided a justification of how one node was merged with another), how many times they were references (or coded) and the number of sources where they appeared:

Table 15: Family-related Nodes

Rank	Node	Definition	References	Sources
1	Business groups – family	Specific reference to the family owners of business conglomerates or as Granovetter notes are business groups; conglomerate node merged with this one as conglomerates are acquisitions with little or personal ties but business groups have them; see if this needs to merge with company-family relationships node - if there's an excuse for separation of these two or if it can be merged; if not Business Groups can be the parent node. Termed as family corporations or famcors in the Philippines.	175	44
2	Company-family relationships conflict	Aspects of how family members relate to the company the family owns e.g. succession planning, control, expansion.	158	42
4	Culture – business – family	The importance of the family and how it plays a central role in the business culture	142	45
6	Theory – Business Groups – Family Businesses	Some theoretical aspects of business groups.	122	32
11	Family business	Reference to the phrase "family business". i.e. business = family so integrated with each other, and business families.	108	36

22	Ownership and control – listing – family	Issues of listing on what it means – such as preparing for it and loss of control for family.	88	19
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Having this multiplicity of nodes allowed me to write better as I had structured the nodes, worked and refined them, and thus subsequently identified as to whether it was a main node. Thus for 972 nodes, I had several main nodes. For the main topic of my research, corporate governance was coded 81 times with sub-categories. The most frequently coded corporate governance nodes were: awareness, applicability of, reforms, perception of, regulators, and practice. A table containing the list of corporate governance nodes analysed in NVivo can be found in Appendix 8.

3.7.3 Coding and Analysing Media Articles

Similarly, I used the same analytical approach in my interview data and applied it to my media text. In NVivo, an Internal folder called “Media” was created with six internal documents (or items) representing the six newspapers these articles came from: *Business Mirror*, *Business World*, *Manila Bulletin*, *Manila Standard*, *Philippine Daily Inquirer* and *Philippine Star*.

The screenshot below shows the list of newspapers, the number of nodes and the number of references. Most of the articles collected came from three broadsheets: *Business Mirror*, *Philippine Daily Inquirer* and *Business World*.

Exhibit 4: Screenshot of Media Folder, Number of Nodes and References

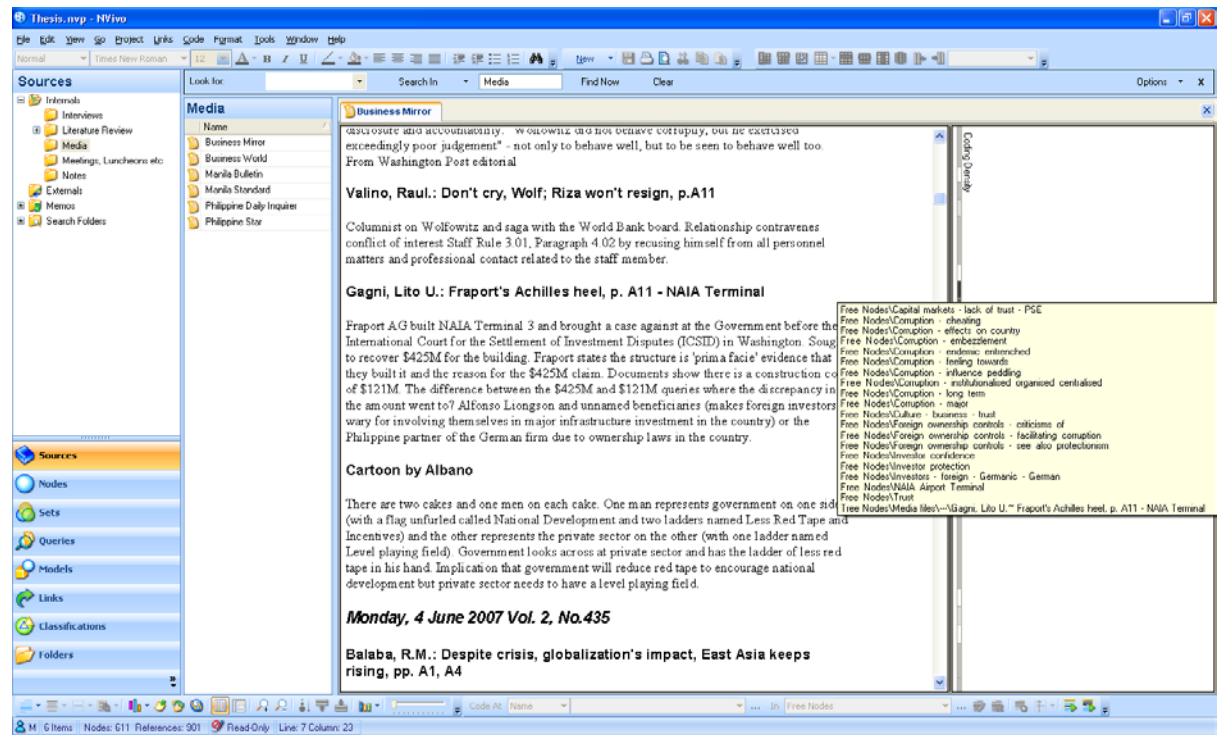
The screenshot shows the NVivo software interface. On the left, a tree view shows the project structure with folders for Interviews, Literature Review, Media, Meetings, Luncheons etc., Notes, Externals, Memos, and Search Folders. The 'Media' folder is selected. The main window displays a table of media items. The table has columns for Name, Nodes, References, Created On, Created By, Modified On, and Modified By. The data is as follows:

Name	Nodes	References	Created On	Created By	Modified On	Modified By
Business Mirror	611	901	17/02/2009 8:11 P	M	29/03/2009 4:19 PM	M
Philippine Daily Inquirer	480	633	14/08/2008 2:43 P	M	28/03/2009 4:23 PM	M
Business World	381	518	17/02/2009 8:19 P	M	12/03/2009 2:42 PM	C
Philippine Star	46	51	21/02/2009 11:52	M	1/03/2009 5:18 PM	M
Manila Bulletin	30	32	22/02/2009 8:57 P	M	1/03/2009 5:06 PM	M
Manila Standard	15	15	19/02/2009 2:09 P	C	1/03/2009 5:09 PM	M

As the newspaper articles were hard copy versions, it took over a period of 12 months for a summary of each article to be typed, categorised, analysed in NVivo as this was concurrently going on with my data analysis of interviews. A summary of the article was typed up instead of transcribing it in its entirety in view of the relevance of the data in the newspaper article. Inputting the data was time and labour intensive however these newspaper articles were at the core of the triangulated methodology I had applied and they substantiated and complemented my interview data.

The next screenshot below shows a Business Mirror article called *Fraport's Achilles heel* which was related to the expropriation of a German-built airport terminal in Manila (see Chapter 9: Corruption; NAIA Terminal). In NVivo, the article was coded thus: Heading 2 which is in italics and bold text for the date of the article, Heading 3 which is in bold text for the author and title of the newspaper article, and Normal text for a summary of the article:

Exhibit 5: Screenshot of a coded media article



The text of the article was coded under the major nodes of Capital Markets, Corruption, Foreign Ownership Controls and Investors. Similarly to my interview data, one line in the text was coded to 19 free nodes reproduced in the following table:

Table 16: Nodes for One Line of Media Text in NVivo

Node	Sub-Category	Sub-Sub-Category
Capital markets	Lack of trust	PSE
Corruption	Cheating	
	Effects on country	
	Embezzlement	
	Endemic / Entrenched	
	Feeling towards	
	Influence peddling	
	Institutionalised / Organised / Centralised	
	Long-term	
	Major	
Culture	Business	Trust
Foreign ownership controls	Criticisms of	
	Facilitating corruption	
	See also Protectionism	
Investor Confidence		
Investor Protection		

Investors	Foreign	Germanic – German
NAIA Airport Terminal		
Trust		

As may be noted, there were some overlap with some categories. For example, a node of Trust was created mostly to relate Philippine society's viewpoint on trust. However, I had also created a trust sub-category attached to the Culture-Business node mainly to code statements of my interviewees where they mentioned trust or which related to the importance of trust in their business interaction. Thus, "Trust" as a concept was important in both business and society. In this particular line in the media article, undermining trust in business (due to expropriation) and undermining trust in society (due to perceptions of corruption) were both applicable. Thus, the line was coded to both nodes.

Another instance where such overlaps occurred is present in the major node of Foreign Ownership Controls (FOC). Under FOC I created a sub-category of "Facilitating corruption". I did not create a sub-category of FOC under the major node of Corruption as FOC was a major node in its own right. In this instance it was about foreign ownership controls facilitating corruption as a foreign investor could not have majority ownership (and therefore control) over its investment. The foreign investor was dependent on the largesse and goodwill of its local partner not to take advantage of its majority ownership in the joint venture. In this case, the foreign investor was sorely disappointed and the case went to arbitration as the terminal was expropriated. Thus, FOC are an important factor in the investment decision of a foreign investor and this was substantiated in my interview data.

NVivo also allows coding stripes for each node hence the multi-coloured stripes in the following screenshot:

[illegible]

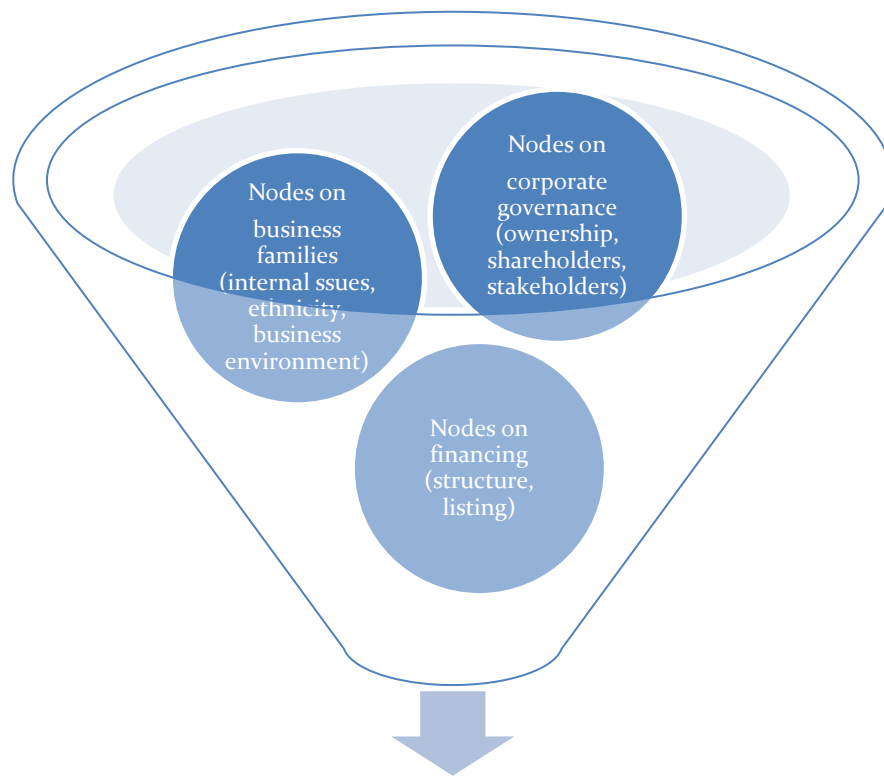
3.7.4 Funnelling: From Analysing the Data to Structuring a Chapter

Why did I undertake such node saturation? Perhaps in a way to ensure that I had covered all possible interpretation of such a statement and to ensure I did not overlook the relevance and meaning of the statement. The subtleties of language are such that what is perhaps most important is what is left unsaid.

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call “funnelling” which brought together all the nodes pertinent to a particular theme. The output produced was a structure of a chapter. Below is a graphical presentation of a funnel that shows how all the nodes I created in NVivo helped structure the writing of a chapter:

Figure 15: The Process of Funnelling and Synthesising the Nodes



Chapter 6 Business Groups: Owners of Companies

For Chapter 6, there were some 300 nodes that were referred to in this Chapter. This chapter focused on the convergence of corporate governance and business families with the additional issue of financing. This graphical representation of a funnel shows how I worked from the macro-level of multiple nodes to finally produce the results and structure the sections in this particular chapter.

While I do not recommend this type of node saturation for other researchers with time constraints, for my ethnographic approach to this research, this was the way that worked best for me. Using NVivo helped clarify the data I had collected by providing a more objective way of seeing, analysing and writing.

Node saturation was a time-consuming aspect of my research that took some nearly 18 months to complete altogether but I had saturated the data to all the possible nodes that I cannot be helped but be satisfied that I had covered every interpretation and meaning of each line of an interview.

3.8 Writing up the Research Findings

Writing up the research findings for each chapter produced its own internal writing struggle or challenge. I also worked backwards with each results chapter. Hence my Chapter 9 on Corruption was written up first as this was the most inductive aspect of my research. While corporate governance is the main topic of this research, underlying any private sector reform in the country is the spectre and effects of corruption. I could not ignore it - nor did I wish to - so writing this first was the most therapeutic way to get it out of the system.

With Chapter 8 on Government Financial Institutions I struggled on its appropriateness as a stand-alone chapter as initially I wanted to create an Institutional Investors chapter. However, the output of rich data from the interviews I conducted with the three government financial institutions gave the added impetus to give them their own chapter.

Chapters 6 and 7 produced a different internal struggle of a structural sort. These two chapters are at the core of this thesis. Corporate governance in essence is about ownership and control. How could I write up the data when ownership and control were frequently one and the same? To overcome this, I finally divided an initial one chapter into two – Chapter 6 which deals with ownership specific issues and Chapter 7 which covered managerial issues. Necessarily, there are overlaps between the two as both chapters complement each other.

Chapter 5 on Regulators was pretty straightforward in that each corporate governance regulator's strengths and weaknesses were described. Perspectives from the regulator and the regulated are featured in this chapter. One poignant aspect of this Chapter was the ousting of the Insurance Commissioner which linked this Chapter to the issue of politicisation that was impressed upon me by the organisations in Chapter 7.

Finally, the last result chapter that I wrote is the first that appears- Chapter 4 on the Corporate Governance and Business Environment. This chapter focuses on the culture and existing business environment when corporate governance was introduced, and how it was introduced. Contributions to institutional theory and an expansion on the understanding of culture is the main motif of this chapter.

Overall, writing up my research findings took some 18 months to complete.

Unless otherwise stated in the text, most of the interview data have been de-identified. This was to respect and preserve the anonymity most interviewees wished for but in some cases, I thought it prudent to anonymise them and the data despite their agreement to be formally identified. Interview data in a particular section are also denoted by numbers such as “private sector 1” or “private sector 2” indicating comments from different individuals in each section. That is, “private sector 1” does not mean the comments come from a specific interviewee throughout the results chapters but rather a comment made by one person in a particular section.

In undertaking an ethnographic approach to my research, the research journey has been far from linear with real life tending to intrude frequently. However, my findings that are accounted for in the results chapters from 4 to 9 reflect the methodological approach I have undertaken in both the collection and analysis of my data.

CHAPTER 4: BUSINESS AND CORPORATE GOVERNANCE ENVIRONMENT

This chapter looks at the business and corporate governance environment of the country. The first half of this chapter examines the culture of the Philippines and its political environment, while the second half looks at the introduction of corporate governance reforms.

The following elements of Philippine culture are discussed: insularity and elitism, family, ethnicity, conflict avoidance, collectivism and masculine. On the matter of the Philippine political environment, the following issues are explored: politicised regulation, politically-connected firms and public sector governance. Included in this section are areas where government can make a substantial difference, political dynasties and the choice the country faces between choosing a path of democracy or dictatorship. Philippine culture and politics provide the context in which the corporate governance environment operates.

Providing a background to corporate governance reforms, the following events and policies and regulations are mentioned: the impact of the East Asian Crisis (1997), OECD Principles of Corporate Governance (1999), impact of the Enron collapse (2001), US Sarbanes-Oxley Act (2002), the main securities regulator's view of the crisis and Enron, and a theoretical reflection the cycles of crisis and reform.

The relevance of institutional theory is explained in the isomorphic process (DiMaggio & Powell 1983) of introducing corporate governance reforms into the country. Coercive isomorphism is discussed along with the influence of international financial institutions (IFIs) to impose corporate governance reforms on countries under their purview which includes the Philippines. Mimetic isomorphism is then discussed to explain the operationalisation of corporate governance on the policy and regulatory levels.

A corporate governance tool developed by the World Bank called the Report on the Observance of Standards and Codes (ROSC) and its effect on Philippines regulators are explained. The natural limitations of institutional theory due to the unintended consequences of isomorphism are explained.

Adapting corporate governance reforms so they are conceptually more suitable to local

conditions is aided by having a figurehead to legitimise corporate governance reforms in the country. The Philippine figurehead in this case is Dr. Jesus Estanislao and he founded the Institute of Corporate Directors (ICD) which is the organisation most actively associated with corporate governance in the country. The role of the ICD in promoting corporate governance reforms is discussed.

4.1 Culture

Culture is an inherent part of any business environment. This section on culture provides the social context of what it is like to operate a business in the country. Culture is embedded in a country's fabric and permeates all organisations. Understanding some basic elements of Filipino culture provides insight into why corporate governance reforms in the country take the form they do and explains the way there were tensions in the way they were implemented.

This section also contributes to supporting Hypothesis 2 of my research:

H2: Post-1997 corporate governance practices in the Philippines institutions and firms will not diverge from indigenous customs.

Whereby the cultural elements of the Philippines, in particular the role the family plays in shaping and indigenising corporate governance in the country.

My interview guide had a specific question on culture. I asked all my interviewees the following:

What are the specific aspects of the business culture in the Philippines that influence the formulation and implementation of corporate governance?

This open-ended question provided a fairly open-ended response and many interviewees were able to provide and reflect on the extent Filipino business culture impacted the operationalisation of corporate governance in the country.

4.1.1 Analysing Culture Nodes in NVivo

I created 72 cultural nodes from the data generated by my culture question. The culture nodes provided support for the integrated perspectives of Hofstede and Teehankee (see Chapter 2: Literature Review on Culture). I categorised the nodes initially into two distinct categories: the business culture and the national culture. The former had 42

nodes, while the latter had 30 nodes. The table below showed my initial culture categories:

Table 17: Business Culture vs. National Culture Nodes

Business Culture	National Culture
Insularity and Elitism (Closed/Insider)	Family
Family	Conflict Avoidance
Conflict Avoidance	Collectivism
Ethnicity	Masculine

As there were crossovers between the two main culture categories and indeed also within some of the cultural nodes, I decided to integrate them. While there may be arguments to the contrary to explore the divisions further, it is not within the scope of this thesis to investigate the fine line where business culture remains distinct from national culture and vice versa. Hence for simplicity's sake, I decided to address all these elements motivated by the recurrence of two main elements in business culture – that of family and conflict avoidance – that also appeared in national culture. Overall, six cultural nodes form the basis of culture in the country.

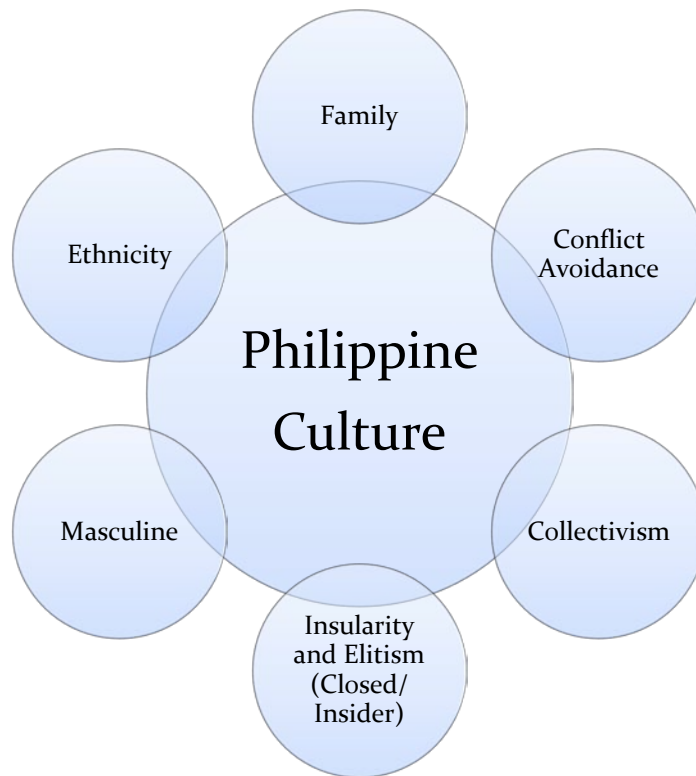
Teehankee's notion of conflict avoidance ranked high. While I had insularity or closed/insider as a business culture node, in national culture the notion of collectivism is closely linked to this perception. Indeed Hofstede's power distance is part of the closed/insider culture and similarly with the notion of collectivism there are two subgroups emanating from this – that of being part of the collective and outside the collective. There is an attitude of elitism if a person is outside the 'collective' or one's circle. Thus, while closed/insider can be argued as being a sub-group of collectivism, the propensity in the interview data to state there was a closed/insider business culture in the Philippines warrants this classification as distinct to the collectivism node.

Closely related to the collectivism and insularity classifications was the central role of the family where exclusivity due to blood ties also ranked highly. Elitism was defined as having gone to the same schools, universities and/or being members of the same clubs.

Ethnicity is also worth mentioning in the culture nodes. The interview data mentioned several business families coming from different ethnic groups in the Philippines. Finally in terms of Hofstede's masculine index, I only found support for this in a minor element of machismo in that assertiveness was displayed by females in high ranks.

The following figure contains the main elements of cultural nodes from my interview data that have an impact on the business environment:

Figure 16: Six Culture Elements in the Philippines



The six main culture elements emanating from my coding of business culture are: (i) insularity and elitism (closed/insider), (ii) conflict avoidance, (iii) family, (iv) ethnicity, (v) collectivism and (vi) masculine. The following sections discuss them in detail.

4.1.2 Insularity and Elitism

Initial categorisation of this node was closed/insider. I later decided to use insularity as the overall term. I also had the boardroom culture distinctive from elitism however given that the boardrooms of the country represented the country's business elite, it seemed natural to make elitism a subset of insularity. The table below contains terms mentioned by interviewees that constituted insularity and elitism:

Table 18: Insularity and Elitism

Insularity and Elitism (Closed/Insider)

- Connections or Network, Inner-Circle, Relationships
- Boardrooms: leadership, ability to make changes
- Rich-Poor Divide, Poverty

Amongst interviewees, there was a sentiment felt about the insularity of the business culture. Interviewees spoke of the elitism present in the boardrooms of the country. Appointments to the board are normally shortlisted through familiarity with someone or some group's network. Personal relationships are also strongly emphasised.

The insider nature and relationships in business was encapsulated by two incidents that occurred during my data collection. During one interview, I was privy to a conversation between an investment banker and potential investor with the former saying to the latter: "Well, 90% of any deal is chemistry and I know you will get along with him."

The other was a private sector interviewee who noted all the friends he had amongst the regulators and fellow industry peers. In one phone call he made, I could overhear the regulator pick up the call and say to him: "Hello my friend, what can I do for you."

How this manifests itself on the board culture is straightforward. The nodes for boards dealt with effective leadership (as most boards were majority populated by management), change leadership (in how to reform the board in light of corporate governance reforms) and the phrase of 'inner circle' which related to the small pool of well-connected or name/trophy directors companies wanted.

As the Philippines is typical of a country where there is a high power distance, my data provides support and concur with some of the sentiments Hofstede outlined. Given boards of directors host the country's business elite, the elements of elitism are ever present:

"We have introduced a chairman circle which involves 5-10 top level company chairmen who would talk about issues regarding the economy with significant shareholders. What we find is that chairmen only listen to their peers and colleagues." – ICD

“People who affect the life of the country in the political intellectual circle are very limited. It is elitist.” – private sector 1

Networks and connections also mattered, in some cases, above one’s talent:

“[You cannot get by on] sheer merit, sheer talent [alone] but knowing the right people gives you the edge.” – academic

As Calero (2007) pointed out, the stratospheric society of Manila means “the first thing people want to know when they meet you is who you are related to. Family ties are very important, especially for the family elite.” One foreigner observed that blue chip boardrooms are normally populated by the elite so the elitism in the Filipino boardroom does not differ from other countries:

“All these connections - they just have a different way of running the business.” – foreigner

Another pointed out networks counted too in other parts of the world:

“If it comes down to a choice between your schoolmate and somebody you don’t know – all things being equal - you’d choose your schoolmate. But choosing on the basis of school ties is not just in the Philippines. It’s universal and the old school ties are not necessarily just Filipino.”-private sector 3

With one interviewee who was rather defensive in his response throughout the interview, he spoke of the norm of speaking to people whom only one knows. As a stranger to him, it did explain his posture throughout the interview. This insularity is a common cultural element in the region according to him although whether this insularity and parochialism is sustainable for the country’s development is another matter. He spoke at length on corporate governance in the country through the prism of cultural considerations:

“The emphasis on relationship is not only in the Philippines but the whole of South East Asia based upon on relationships. We don’t do business with strangers, which is also the Chinese way of doing business. Hong Kong and Singapore are not so relationship based [I interjected that these two countries who were more “open” were doing well]. I’m not sure about corporate governance being altered culturally. If you’re going to develop that kind of law,

the cultural way but not on the corruption side – in establishing relationship-based corporate governance, there is a need temper it with disclosure and transparency. So that it may be said that though we may be related (i.e. not relatives, but friends etc) our relationship is transparent. When I say relationship it is not relatives. But you cannot just get somebody from the outside world and just get them in.” –private sector 4

Insularity also manifested itself in the rich/poor divide and complemented the high power distance of the country. The gulf between the few wealthy elites and the mass poor was acknowledged by several:

“You have the middle class rich who are not really rich or super-wealthy such as the middle class in Australia. This middle rich is embarrassed by wealth. My parents earned their wealth. It’s the other way around here. The [very rich] flaunt their inherited wealth – they flaunt it, as they have it. It’s very hard to hush inherited wealth.” –regulator

In well-defined superior-subordinate relationships, fealty borders on the feudal not only in business life but also the greater political life:

“We’ve allowed our leaders to perpetuate the system. It’s feudal: The handouts from the *amo, masaya ka na*. (If you receive money/goods from the boss, you are happy/content). The Philippine economic structure is part of corruption. We don’t even have basic industry as we’re importing [everything]. I hope we can have as little government as possible. Political dynasties are more of a sign of how the political economic structure is set up. We are a protected economy until we open up. We are so used to a feudal system. What gets replaced is still there with the landlord and that creditor power. 80%-90% of Filipinos are poor – it’s democracy in lip service, not democracy in the real sense of the word” –private sector 5

“The perception amongst the masses is only the rich can get justice in the system, and that perception hasn’t changed.” –private sector 6

“The oligarchies here are above the law in a weak state. They own the politicians.” –private sector 7

The last two comments point out the ultimate expression of insularity and elitism: that of the oligarchical nature of Philippine society where a few families control the country with their actions affecting the lives of so many.

4.1.3 Family

The family is the key factor in determining and modifying corporate governance in the country. This research explores how family ownership in corporate governance processes and external standards are modified by this basic underlying feature. This characteristic of the private sector of the Philippines is explored further in Chapter 6.

The family in Philippine business culture is central with one interviewee pointing out this was the norm for the rest of the world, aside from the Anglo-American sphere:

“Family corporations here are culture. It is not formal. But it is not different from the rest of Asia. The Anglo-American corporate governance structure in terms of concentration of ownership is an exception rather than the rule. Even Scandinavia has family-owned concentration of corporations as well.” -academic

Thus the conundrum of introducing Anglo-American corporate governance - which is largely non-family based - to the rest of the world where the family is at the core of private sector activity. My interviewee pointed out one big factor for the proliferation of such Anglo-American precepts was due to the established dominance of corporate governance research coming from this cultural sphere:

“The researchers are coming from the US and UK hence the bias of corporate governance towards the Anglo-American model. Their data looks at the concentration of ownership in the USA, UK and even in Australia. But in Asia, family corporations form a big part of the economy in terms of family structure. Family-owned corporations are so dominant in the country as in many countries in Europe.” -academic

The fundamental difference in the ownership issue of Asian and indeed Philippine corporate governance from its English-speaking counterparts determines the nature of corporate governance research in the region. Internally, business families confront issues that are family-specific. For business families, they face the challenge of ensuring there is a proper delineation between business issues and business family issues. These issues

include generational transfers or succession, the sentimental value of the business, relationships with siblings and inheritance. Again, Chapter 6 deals with how business families deal with these issues extensively.

For this section, the impact of the family on business culture is set out in the following table:

Table 19: Culture nodes relating to the family

Family
<ul style="list-style-type: none"> •Generational, succession, sentimental value of business, siblings, and inheritance •Kinship, <i>kapwa</i> (togetherness), loyalty, respect for elders •Sense of entitlement, Nepotism, Meritocracy (or lack thereof)

Extending the centrality of the family in Filipino life, there exists the notion that when an employee joins a business, s/he also becomes a member of that family:

“In Far Eastern University (FEU), we are used to consider ourselves as one big family. Some employees would say they graduated from here, studied here, I met my husband here, I can never repay what FEU has given me.” - FEU

The notion of kinship means loyalty. This is to ensure there is loyalty to the family and not betraying that trust fostered when joining a ‘family’. Loyalty to the family is core:

“The Philippines is family-centric. Somebody once described the Philippines as a country of families and tribes.” – private sector 1

“There’s also the ‘*tayo-tayo*’ (we-us) mentality. In a larger cultural context, there is that tribalism in this country.” – private sector 2

In contrast to the prevailing attitude in some Western countries, a reverential respect for elders was poignantly pointed out by one interviewee:

“[On culture] we have the concept of *pakikisama*³⁰ and brotherhood. Sometimes it happens to get in the way but it is not bad per se. *Pakikisama* also emphasises the elderly, we respect them. In the West you put the elderly in nursing homes, it’s not good. It’s good there but bad here.” –business family member

³⁰ Pakikisama generally refers to the ability of getting along with each other. See section on Conflict Avoidance.

Seniority was also placed above meritocracy:

“Seniority plays a big role instead of meritocracy especially in family corporations.” – business family member

Indeed, the notion of meritocracy has some way to go in family-owned corporations. This is linked to the inherent regard that family members will be more loyal than professional managers. Or as the old adage goes: “blood is thicker than water.” Therefore, loyalty outweighs meritocracy:

“The cons [in family businesses] are you don’t always get the best men on top for example those [non-family members] who have better qualifications. There could be some source of conflict there.” –business family member

“A loyal employee is better regarded than a more competent employee because with the former, you can depend on their loyalty.” – private sector 3

Several interviewees also mentioned the downside of emphasising the family. Not only does the sense of family creates a sense of entitlement amongst members and allows the proliferation of nepotism, it does prevent a greater sense of empathy or caring beyond the world of the family. This is linked to the “inside the collective” perspective, where outsiders and outside interests have less of an impact. One interviewee asked if the family could be blamed to some extent on inhibiting the development of the country:

“Before you get to country, there is loyalty to family, friends and schools. In the USA, the civil war tore apart families. These are cultural things – are they (family) inhibiting development or do they allow things to work?” – private sector 4

While another pointed out the dominance of the family was due to the weak and authoritarian state of the country where formal civil institutions cannot be relied upon - the family is people’s social security net:

“There is a weak sense of public. We have a perspective that looks at the community very narrowly in terms of immediate family. Certainly you have to look at the family as basis for understanding the problems of the Philippines but you can’t dismiss it. The family is the basis for security for people. Any reform will come from that system as well. The weak sense of community that we have here [is offset] by one’s own sense [and security in the] family. It is a narrow,

short-term view but it is linked to the lack of trust in institutions that are larger and the sense that if you wait for your turn, you won't get anything. The family is their social security net. Unless you [the state] can provide, people will continue to rely on families.” – academic

Unless the state can provide the services most Western governments do provide to its citizens, people will continue to rely on families. Therefore, in order to live with the uncertain environment, people have come to rely on the institution that can be trusted the most - the basic unit of the family.

4.1.4 Ethnicity

Closely linked to the family is the ethnicity of the dominant business families in the country. Similar to the feelings and attitudes displayed in Sales' (1979) seminal study of Quebecois business elites, my interviewees frequently pointed out the ethnic group of the business family as possessing different cultural values and traits. The main ethnic groups mentioned by interviewees are outlined in the table below: Filipino-Chinese, Filipino-Spanish, Filipino-Malay and a culture defined by an amalgam of Oriental and Occidental values:

Table 20: Main Business Family Ethnicities

Ethnicity
<ul style="list-style-type: none">•Filipino-Chinese, Confucian, Taipans•Filipino-Spanish•Filipino-Filipino (Malay), East Asian•Fusion of East and West

4.1.4.1 Filipino-Chinese

While trade between China and the Philippines has had a long history since pre-Hispanic times, waves of Chinese immigration in the aftermath of general political instability in the early 20th century, due to the Cultural Revolution and political prosecution under Communism, that catalysed the establishment of an entrepreneurial class defined by their Filipino-Chinese ethnicity in the country.

Given the dominance of ethnic Chinese business family groups in the development of East Asian economies, the perception that this group dominates the country's economy

has some merit – to an extent. Proportionally wise as percentage of population, they are over-represented in the list of big business groups and are widely considered as forming the entrepreneurial backbone of the country. But it is fair to say that the other ethnic group, the Basque-Filipino business families, are also overtly represented. Combined, these two ethnic groups dominate the economic landscape of the country. There is a perceived rivalry between these two groups although it could be based upon business interests rather than ethnicity.

The Filipino-Chinese, colloquially known as *Tsinoy*s, dominate the country's rich list (see Table 27 on Forbes' Top 25 in the country in Chapter 6):

“It's the Filipino Chinese which grows the economy of this country than the Filipino-Filipino or Filipino-Spanish.” – Filipino-Chinese

For the top Filipino-Chinese tycoons, the word *tai-pan*, which was first used to describe heads of major business houses forged in colonial Asia (especially in Hong Kong) in the 19th and 20th centuries, the term has proliferated to encompass them:

“The *taipans* are the following families: The Sys, Tans, Gokongweis, Yuchengcos, Gotianuns.” –manager

“The *taipans* of the Philippine business environment include the Yuchengcos and the Cojuangcos.” –regulator

Several interviewees pointed out the dominance of a group of Filipino-Chinese business families in a particular sector such as the Philippine Stock Exchange (PSE):

“The exchange is dominated by the Filipino-Chinese.” – private sector 1

“[My interviewee] also spoke about the power of the Chinese-Filipino stockbrokers over the PSE...and that while they are small they protest a lot and are disruptive even though most of the trading – by volume and price – is done by foreign brokers.” – interview observation notes

Filipino-Chinese values shaped by Confucianism with its respect for elders/seniority, social harmony and keeping things such as succession within the family were mentioned as particular traits:

“They have started to professionalise as they are traditional Chinese and

practising business in a more diversified manner. The Chinese traditionally see the company as their family business. The family is involved in the business as very few members do something else besides the family business.”-private sector

2

While another interviewee pointed out that the relationship-based nature of Chinese culture meant disclosure and opening up to strangers or outsiders take time:

“It is important that there is a great deal of trust first especially amongst Filipino-Chinese families. Introducing reforms take time as you have to talk to different members of the family. It takes time...*Guanxi*, relationships still dominate in China...With Chinese companies, it is hard to get permission. They require time to open up to you. They are not excited about people writing about them. It’s an indirect indictment [of their wealth and influence].” – private sector 3

Interviewees made the distinction between those who were born in China and those who were Filipino-born. The latter is expected to have a level of acculturation with his/her country of birth and a well-cultivated emotional distance from China than with the former’s émigré status. The following commentary is testament to this eventhough the ‘Chinese’ in question has lived most of his life in the Philippines:

“[After the family] the next highest shareholder is owned by a Chinese.” –private sector 4

For one Filipino manager working for a Filipino-Chinese business family, he observed that the second generation was caught between these two worlds: of having an ethnic background but growing up in a different dominant culture. The founder had integrated somewhat by marrying outside the ethnic-Chinese community:

“The family consider themselves Filipino citizens of Chinese. We call them *intsik* (Filipino word for Chinese) which is not a nice thing to say...Aside from the patriarch, all the children were born here. The mother is from here. They are more Filipino than anything...I was organising a joint venture with [a mainland Chinese company], and I asked the son to translate the Chinese characters for me, and he said I don’t speak Chinese. It’s like learning Chinese, he learnt some basic words but he grew up Filipino.” –private sector 5

Overseas networks of ethnic groups provide a solid foundation in terms of providing a commonality linked by language, culture and descent. However, not all ethnic Chinese families in the Philippines have grown to own and manage a business enterprise.

In general the organisations I spoke to are believers in corporate governance and ethnicity is sometimes given too much credit in the discourse. The “Asian values” that is sometimes espoused was less of a factor amongst interviewees. The fact of the matter is, the private sector interviewees I spoke to had more pressing problems on their mind (such as their relationships with government) than their family origins. After all, they were all playing and competing in the economic field of the Philippines.

From a regulator’s point of view, succession planning is gaining currency since a group of these largely Filipino-Chinese founder-entrepreneur businesses are ready to pass the baton to the next generation:

“I was once invited to a Chinese Filipino family-owned company that was not regulated by the SEC. I asked them, your corporation is not publicly listed, why are you inviting me to speak on corporate governance? I don’t consider myself to be a proper guide to lecture on corporate governance to your fathers and sisters. He responded, impress upon them that it’s a coming trend. If we practice corporate governance now, it will save the company from the boredom of the next generation.” – SEC regulator

For Filipino-Chinese conglomerates, there is some sensitivity over their loyalties to the nation and this was touched upon by a couple of interviewees. Not in a defensive way but in almost the incandescent vulnerability over irrational xenophobia. It must be remembered that loyalties to one ethnic group can vary from one individual to another especially if the person is born and bred in the country yet questions over one’s loyalty may remain due to artificial elements. There may also be confusion over one’s identity as this contradictory statement indicates:

“If you’re Chinese, you’re always Chinese. That’s the beauty of being Chinese. Relationships are emphasised in the China market. [pause]. But we are a pure Filipino company.” – private sector interviewee

In one interview, the elephant in the room (one’s ethnicity) was not mentioned at all although at the initial exchange of business cards, my interviewee’s card had one side

with Roman characters, and the other the Chinese characters. Responses became hedgy when I asked about the company's expansion into China. Truly, they were a Filipino company, and the Chinese market was another place for expansion.

4.1.4.2 Identity over Ethnicity

Identifying one's self to one ethnic group can itself be quite limiting. Having grown up in multicultural Western Sydney, diversity is part of the norm and Balkanisation of student groups is sporadic as students from different ethnic backgrounds mix freely with each other.

This of course does not discount that ethnicity does not wholly affect the business networks and arrangements on some level. However, the core goals of my research were less concerned with ethnicity and there is no intention in this section and let alone be interpreted as such that I seek to make light and treat this issue in a superficial manner. Needless to say, there are better informed ethnologists and academics more able to probe into the complexities of ethnicity and its bidirectional relationship within the Filipino business environment (see Lee-Chua 1995, Limligan 1986, de Borja 2005). The scope of my research however is limited to treating this issue briefly in these pages and future studies can address this.

I came across Chinese Filipinos in the academic, public and private sector spheres and ethnicity was little or no issue at all when talking to me. Identity rather than ethnicity counts. When I interviewed my exuberant, ebullient, and jovial Filipino Chinese businessman he spoke about having to learn four dialects in the Filipino province he grew up in because from one town to another, the language was spoken differently. It made commercial transactions difficult unless one was fluent. The only time he mentioned racism directly in the interview was in his overseas experience. The following monologue is his story and an insight into how the country needs to operate out of isolation:

"I am an American citizen as I have lived in the USA for awhile. However, I wanted to return for nationalistic reasons and because the lifestyle is easier for me here although most of my family lives in the USA. In the USA I was a Vice President at [an MNC] but I faced some racism there. They made fun of my accent, saying "He doesn't speak English properly" and mimicking me at one

meeting. I will never be Western or 6 feet tall so having grown up here, I would prefer to do business here.

“Here in the Philippines, everyone is connected. In the USA, in Silicon Valley, if I go to a government office, I get what I need. In the Philippines, we look for a friend in a government office. Even if they are not the right person to speak to, they would feel insulted if we didn’t go to them in the first place. It’s *delicadeza*, it’s the Filipino way. If you want expedience and to save time [you use your connections]. In the USA, it’s called networking. In the Philippines, you get to know these guys as part of networking. You can’t remove the network system. There’s the old boys’ club in LA, New York. Here, a lot of business leaders studied abroad in the US so there are the Harvard, Wharton and Stanford Clubs.

“To work abroad, we have to recognise [corporate governance]. The Philippines is not the centre of the universe. We have to be more pro-active, above board, and transparent.”

Like the experience of other Filipino professionals who have worked overseas (and carry with them that cachet of experience) and returned to the Philippines, they carry with them a sense of purpose and a feeling of being able to witness the possibilities of change in the country.

4.1.4.3 Other Ethnic Groups

In contrast, interviewees’ views towards other ethnic groups mentioned were more ambiguous. For Filipino-Spanish business families or *mestizos*, their dominance reached its zenith under Spanish colonial rule. However, the onset of World War Two and the dictatorship of Marcos saw mass emigration of this group and businesses broken up never to revert to its pre-war eminence. Nevertheless, the handful of Filipino-Spanish business families still having an impact of the economic life of the country, namely the Ayalas and the Aboitizes, are testament to the endurance and successful execution of the family’s internal processes, and ensuring their business passed through succeeding generations. Unlike the Filipino-Chinese, where most of them are now handling issues of first intergenerational transfer from entrepreneur to son or daughter, the Filipino-Spanish have experience on their side in generational wealth management. For ethnic Filipino-Filipino or Filipino-Malays, entrepreneur Manuel Pangilinan and the Lopez Family were mentioned as falling under this category.

As the country has seen various Western powers impose and spread their cultural values and norms, a couple of interviewees pointed out that the country was a fusion of Asian and two schizophrenic Western colonial legacies of Latin (Spanish) and Anglo-Saxon (American) values. While Philippine business is dominated by a substantial ethnic-Chinese presence, commerce and trade is also global. The country is not immune to ideas being generated from one side of the world to the other. The following passage articulates how cultural values can only impact to an extent the way of doing business in a globalised world:

“We’re not Confucian although we have Chinese companies. There are Confucian values. If we’re not Confucian, we’re Western in our business leaders so we are between Confucian and Western. We’re not as confrontational but it also depends on the individual. Business in general has become more homogenised. Everyone reads the same books by the same [business] gurus around the world. So it’s very hard to say on how much culture impacts. In business, you aren’t necessary *hiya* (sense of shame). There’s a tendency to do that in business and it is not only limited in your circle. We tend to be personalistic. The top businessmen are mostly Filipino-Chinese with Confucian values. It does make us unique as it is more Confucian. But are we *hiya* in business? Businessmen are hard-asses. It does influence but only to a certain extent. We would go along with it until up to a point bordering on the legality. We do not rock the boat but it really depends on the individual and where their limits are.” – private sector lobby group

This was echoed by another stating commercial practice overrode cultural traits:

“In a large cultural context, there is that tribalism in this country. (Discussion about business competing on a global level) We are a Filipino company so we have the peculiarities of our environment. We have to show ourselves to be a very flexible organisation. The best practices where we could add value to our business ensures the long term viability and growth of our company so we don’t let culture restrict us. Since we have started buying raw materials for our markets in the EU, Japan, US, Taiwan and Korea; we have had to deal with MNCs. Their expectations and business suppositions are doing things the Western way. We are a fusion of Western and Filipino Asian business practice.” – listed company

Thus, while ethnic elements may provide an explanation of particular business practice, commercial reality dictates a realistic view of doing business with or without culture's 'restrictions'. Caution must be made with regards to claiming the ethnic identity as having a strong impact than it really does. Commerce, trade and entrepreneurialism tend to be less discriminatory although in an environment which fosters a business-political axis, ethnicity can be a powerful tool for a discontented population.

All business groups – and indeed all companies – I spoke to face a common set of challenges in the Philippines (see Chapter 9: Corruption]. Corruption does not discriminate on the basis of one's ethnicity according to my interviews. However, corruption was and is retarding the country's economic growth and preventing the country from joining and participating in the greater pan-Asian economic development that has thus eluded the country. Indeed the overwhelming sentiment was hope for the cycle of economic growth, jobs, increased unemployment and reduced poverty. The business environment may favour the politically connected, but ethnicity is not a pre-condition.

4.1.5 Conflict Avoidance

While Hofstede deemed the country to live with ease with uncertainty, his initial study did not pick up on the degree cultures avoid conflict. The Philippine culture is sensitive to conflict and many things are done to avoid confrontation. Mitigating the generation of bad blood or enmity between feuding parties is an important trait. The following table lists frequently mentioned words by interviewees that highlight elements of conflict avoidance:

Table 21: Elements of Conflict Avoidance

Conflict Avoidance
<ul style="list-style-type: none"> • <i>Pakikisama</i> (ability to get along with another), smooth interpersonal relationships (SIR) <i>malasakit</i> (empathy), <i>hiya</i> (sense of shame), <i>sensitivity</i>, <i>delicadeza</i> • Emphasis on body language than what is said • Facilitation, Negotiation, Compromise, Passive, Photogenic, Politeness, Respect

The notion of *pakikisama*, or the ability to get along with one another, was particularly emphasised. High conflict avoidance in the Philippines is encapsulated in the concept of smooth interpersonal relationships (or SIR) which is a variant of social harmony and is part of social acceptance in the Filipino context (see Lynch 1981):

“There is a sense of propriety of never confronting. The US cliché is that the Filipino is wily; that’s a failure to understand the Filipino will not say no as that will cause a loss of face. We view it differently. For a Filipino, read and emphasise the bodily language over the spoken language.” – economist

Social harmony in relationships are highly emphasised which complements the cultural element of insularity:

“We are very relationship driven. There is that Malay culture element of having smooth interpersonal relationships and not being confrontational.” – private sector 1

“You have to understand it and give importance to relationships. That’s how things work here. It’s personalised here. Almost everything is around relationships on how to get things done.” – private sector 2

Facilitation, negotiation, compromise were techniques cited to manage and avoid conflict:

“Here, it’s really on dealing with people you know – your friends, people you grew up with. There’s also a feeling here of ‘*pakikisama*’ (going along with others, compromise). You deal with friends, people you already know. The business partners are on a professional level but they would have been working together for quite some time. Directors that have been here don’t view only each other as colleagues but as friends. Filipinos don’t like confrontation. We always want compromise and try to accommodate everyone.” – holding company

Or if conflict must take place, it must be done behind closed doors or done in a manner where the ‘face’ or one’s *hiya* is saved and mutual respect is recognised. Interviewees spoke of *delicadeza* which is related to the word delicate or being sensitive with one’s actions to ensure no harm is done to another’s ‘face’. Closely following *delicadeza* is deep empathy or *malasakit* of another’s situation. Appreciation of these cultural features is

necessary in order to understand how people interact in the country. Though as one put it, high conflict avoidance is a deterrent to proper corporate governance processes being implemented:

“Criticisms here are taken too personally. On the board, there is very little discussion, a lot of feeding through. There is hesitancy to confront. It is a deterrent to real corporate governance. Corporate governance operates in an open environment, honest thoughts, and the ability to criticise without being personal.” – private sector 3

This observation was echoed by another and he explained how conflicts in the boardroom are mediated:

“Things here are taken personally...Confrontation doesn’t happen in the boardroom. If the difference is of a fundamental nature, it does not get sorted out in the boardroom but backroom through a mutual intermediary.” –economist

However, several interviewees pointed out this aspect of conflict avoidance does not wholly recuse responsibility or the ability to make the hard commercial decisions when required:

“*Pakikisama* is on the ground to a certain extent. But this is not an excuse to mask shortcomings. It does not mean closing off the possibilities of bringing new ideas and practices because this would trigger in-breeding which will be bad in the long term.” –listed company

“On the merits of team work of *pakikisama* or of getting along, if you use it for covert intentions, then you use it for elements of deception.” – lobby group 1

Another pointed out the sometime roundabout way of addressing issues where disagreements may arise can be subject to misinterpretation:

“The problem for us is everything is personal. It’s all related .It’s tough separating the personal from the professional. It’s difficult to do that here. Look at the family, there is a lot of emotional baggage. Culturally in fact we’re more sensitive in our communication styles (than Western families). In the West, people can deal with conflict, there is a level of openness and you can say things directly.

Filipinos need to read between the lines: there is scope for being interpersonal, to interpret [but also] misinterpret. The values are different.” – academic 1

Nevertheless, long-term relationships are far more important than a disagreement over a potentially divisive issue. The value placed on long-term relationships outweighs quibbles with erring on the side of good relations rather than the other taking precedence:

“When [an issue] has to be tackled, there is no way of avoiding the issue so we run a meeting. We’ll hear both sides but we’ll face issues head on. So they are elements of *hiya* and *pakikisama*. We’ll go on but shy away from controversial issues. For business people if that’s the business in hand, we’ll have to address it. If we don’t have, prudence dictates it is better to have good relations than not.” – lobby group 2

Some situations do demand the ability to talk directly with the possibility of alienation and this becomes a bit contradictory as one pointed out:

“At the same time, we are faced with images of Hollywood and USA where we walk and talk American but in our relationships we have ambivalence so it becomes a bit schizophrenic. When you’re talking about principles of corporate governance, you have to be unpleasant. Related party transactions are not pleasant.” – private sector 4

For one foreign interviewee, he pointed out the disadvantages of the highly individualistic culture of the West and sees the positive effects of *pakikisama* not only in the Philippines but in the region especially in its ability to move forward in a consensus manner:

“How do you apply *pakikisama* to a capitalist model? Loyalty is thin in this model and is it possible to have smooth relationships? It’s important not to look at *pakikisama* as a negative. In the capitalist model, it’s a dog-eat-dog world and highly individualistic. Here in the Philippines, I have never ever seen a case of road rage. There are elements in every culture that is as bad as it is good. Is the Philippine culture here corrupt because of its former colonialists (Spain/USA)? If you go to Hanoi, they criticise their government and when you mention the war there, they’d say it was over ages ago.” – foreign interviewee

Being able to make decisions with the general agreement of others without major conflict is a hallmark of Philippine business culture.

4.1.6 Collectivism

The collectivist culture of the Philippines supports the high power distance and high conflict avoidance in the country. The most frequently used word in my interview data is the word “we” which denotes collective responsibility and collective decision making especially when responding to questions in my interview guide. Below shows the most frequently appearing 20 words from my interview data, with the topic of this research, corporate governance, ranking 4th and 3rd respectively:

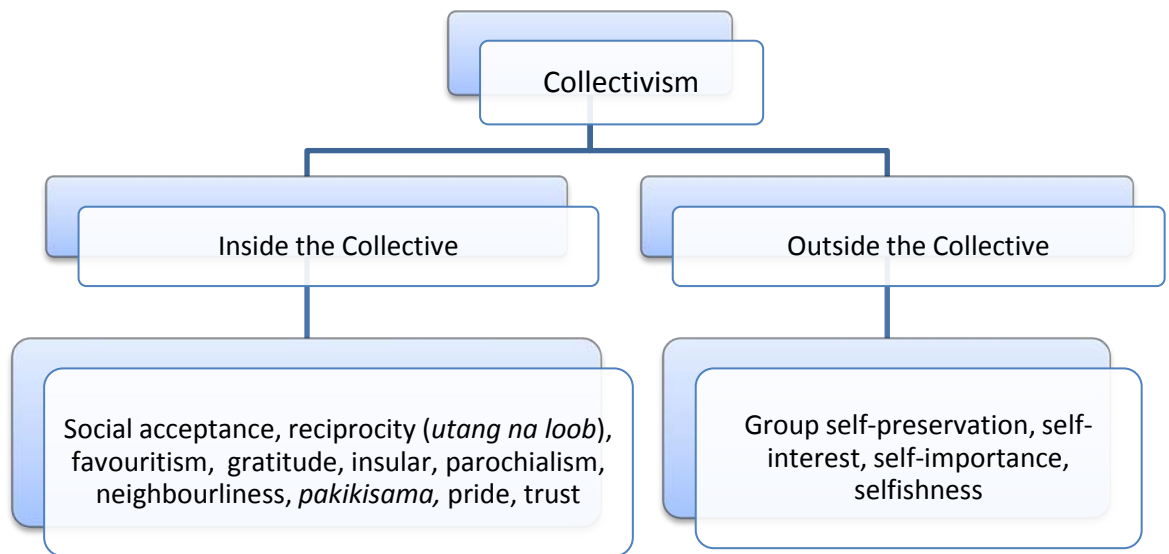
Table 22: Top 20 Most Frequently Used Words in Interview Data Generated from NVivo

Rank	Word	Word Count	Rank	Word	Word Count
1	We	2048	11	Company	918
2	Have	1941	12	More	909
3	Governance	1489	13	He	906
4	Corporate	1425	14	Family	902
5	From	1356	15	Board	869
6	Has	1210	16	Government	819
7	An	1125	17	Which	788
8	I	1085	18	One	782
9	Business	986	19	So	777
10	You	922	20	Philippines	714

In defining collectivism in the country, it is interesting that the perception of collectivism can also be quite selfish. Collectivism is also linked to the business culture of insularity. In the matter of collectivism, those outside one’s network can find it a different culture to penetrate. With collectivism there is a dichotomy: there is a sense of generosity to insiders; equally, there is no obligation to be generous or reciprocal to outsiders. Thus collectivism has two faces –collectivism as a group, and self-centredness and a distrustful attitude towards those outside one’s group.

In this sense, I delineate the collectivism element by defining perception of being “part of inside the collective” and attitudes towards those on the “outside of the collective.” The latter perhaps defines why there is a strong element of elitism, exclusivity or arguably social divide – you are part of a group or not. Below is the dichotomous representation of collectivism:

Figure 17: Dichotomy of Collectivism



If a person is inside the collective, the feeling of “being one” with other members of the collective is present. This empathic feeling provides support for this group version of self-actualisation as depicted by Lapeña (2002) in Chapter 2. Being inside the collective means there is social acceptance, reciprocity and mutual trust that bypasses any organisational constraints. Too much of this in the case of the latter may facilitate corruption (see also Chapter 9 where patronage and group membership overrides organisational boundaries). Several interviewees provided insights into what high insider-collectivism means when enacted:

“It is not so much corruption or bribery but undue influence in a sense. Here, there is so much on the family connection, of doing favours.” –private sector 1

“There is also the aspect of gift-giving. We like to give. It is taken in different context in corporate governance. If you refuse a gift, it offends people. It’s part of the culture” – private sector 2

“In the Philippines, we look for a friend in the government office. Even if they are not the right person to speak to, they would feel insulted if we didn’t go to them in the first place. It’s *delicadeza*, it’s the Filipino way” – private sector 3

The referral system is a feature of Philippine business relationships. A big part of the

snowball effect (as in Chapter 3: Methodology) in my data gathering was the subsequent referral of people for me to interview. While it is arguable that the elites in every business culture – whatever country – have a referral system in place whether through formal networks such as conferences and chambers of commerce events, the referral system in the county is far more personal, relationship-based and informal.

At the other end of the spectrum, if one is outside the collective (whether it be by ethnic group, school and college ties or family membership), the group becomes self-interested, self-preserving and self-important. Exclusionary elements come into play dealing with those outside the collective. While not so black and white, the element of “if you’re not with us, you’re against us” attitude is present:

“The value system here is driven by families: Where are you from? Who’s your partner for the business commitment? Something comes up with a family that overrides everything. The priority has completely changed. There’s a selfishness aspect here. I observe it when people walk, drive, the person will stop, do whatever they want, walk from one side to the other side of the road. What comes first is what they want to do. It’s indicative of a lot of what’s happening here. What it is, it is related to bribes. It’s selfishness that’s predominant. The Filipinos are also proud.” – private sector 4

“There is a matter of how you control and control in a responsible manner. There is a selfish streak here which is to amass as much wealth as possible.” – private sector 5

Attending a corporate governance workshop, the theme in bold letters spelled out: “Country Above Self.” For a highly collectivistic culture, it is almost contradictory that people in this country whose identity is forged and defined by which group they belong to can at the same time have problems in uniting and working for the common good and common welfare of the nation. Thus, in this aspect, this research uncovers the contradictory nature of collectivism: membership of a group also has exclusionary aspects. That is, while this particular East Asian culture is highly collectivist and family-oriented - it can also be quite insular. Understanding the dual face of collectivism and the importance of group membership is supportive of a culture that is highly insider with high social barriers to entry.

4.1.7 Masculine

The last of Hofstede's cultural index masculine-feminine, is marginally supported to some extent by my interview data. However, it doesn't feature prominently as much as the others. The Philippines tends to rate highly on the side of masculine in the index which is defined by assertiveness and the traditional role of the male as the breadwinner in the society. The table below shows the masculine elements in my interview data:

Table 23: Elements of Masculine

Masculine
•Assertiveness, Machismo

The latter is displayed in the *machismo* attitude some interviewees pointed out as being present in the business culture of the country. However, proportionally, women are better represented in senior management roles in the Philippines. As one interviewee pointed out, the strong Filipina is not an uncommon feature:

“Culturally, Filipino women were brought up to take decisions and there are powerful women up the corporate ladder. They are very accomplished so there's not much discrimination in place. The women were brought here to take responsibility in the family environment. The boys are pampered.” –private sector

6

This reflects Hofstede's observation that in a masculine culture, women tend to display more assertiveness.

4.1.8 Concluding Remarks on Culture

In viewing culture in the Philippines, the above mentioned elements must be integrated to appreciate a better understanding of the business environment in the country. The interrelatedness of one element to the other does bring to mind the egg-chicken problem. Is it because of the centrality of the family that produces an insular, elitist, and/or collective culture? Is conflict avoidance and insularity the manifestation of a collective culture? Does ethnicity really matter in the operation of a business given all business families are united by the common threat of dealing with a sometime predatory

state? These unexplored questions show the limitations of this research but also shows the fundamental, enduring importance culture holds in this research. The next section in this chapter provides support for culture's impact.

4.2 Political Environment

From the cultural arrangements of the country to the more prosaic political composition, the business environment of the Philippines is inextricably linked to the politics of the country. This section looks at the relationship the private sector has with the state. The external, pragmatic relationship between business and state has strongly manifested itself in the unsavoury aspect and pervasiveness of corruption in the country (See Chapter 9: Corruption). This section looks at the impact of the dysfunctional state on the corporate governance environment and the private sector. This section contributes best to the ongoing debate on the varieties of capitalism around the world as indeed the varieties of corporate governance that have taken form in order to operate across varied socio-political environments.

Similarly to the previous section on culture, this section contributes to supporting Hypothesis 2 of my research:

H2: Post-1997 corporate governance practices in the Philippines institutions and firms will not diverge from indigenous customs.

Whereby the political instability of the Philippines, in particular the lingering effect of the Marcos dictatorship has made a profound impact on business practices.

As the Philippines is neither a fully-functioning capitalist free market country (like the USA, Australia) nor one that is heavily directed by a strong state (such as South Korea, China), the government's influence and impact on the private sector has been viewed as a major hindrance (rather than facilitator) to the economic development of the country.

When interviewees were asked about what can be done to improve corporate governance in the country and whether there were effective government institutions, almost all interviewees emphasised the importance of government in any reform process. A substantial proportion of the comments were highly critical of government's actions and positions. Being part of ASEAN, the Philippines' lack of economic progress relative to its peers brought out the despair and frustration from interviewees and their relationship

with government. At the same time, most were unified in their response that the solution also lies in government and that the public sector must also lead by example.

This section summarises the attitude and opinions of the private sector on the political environment of the country, and its relationship with government.

4.2.1 A Challenging Environment

The political environment of the Philippines is a difficult one and the dysfunctional politics affects the country innately. As Hutchcroft pointed out:

“successful economic development has been constrained to a large extent by weaknesses of political development” (1998:4).

The frustration felt by those who see the country ‘being left behind’ as other countries in the region develop rapidly is palpable. It is not the lack of intellect, willingness to work, or entrepreneurialism (after all millions of Filipinos have migrated elsewhere and become citizens of and contributed to their adopted lands). Rather, it is the political system and its effects on the government institutions it controls that have largely constrained the natural talent of the country’s citizens to improve and contribute to the country’s development. As The Economist pointed out, government policy is at the core:

“Business groups cite several reasons for giving the Philippines a low competitive ranking: widespread perceptions of government corruption; poor infrastructure; bureaucratic red tape; and unpredictable policies. The problems outweigh advantages such as the availability of a trainable workforce and the population’s general openness to foreigners. Declining English proficiency among workers is an increasing concern. Many investors find business regulations complicated and burdensome, particularly procedures in business registration, customs and immigration. Investors often view the courts’ propensity for issuing temporary restraining orders on issues affecting business as detrimental to foreign investment, as is weak enforcement of regulations.” – Economist Intelligence Unit (EIU 2008)

From the viewpoint of the private sector, its relationship with government is oft-described as a challenging experience. A big obstacle to the country’s economic growth is the inefficiencies of government. One interview I had was with a group of businessmen

and the frustration by these eminent people was obvious in the room during my interview:

“The board are all concerned businessmen. They work on the policy level and there is a feeling of frustration with the current business environment. One left after my question on government and whether it has been effective and what can be done. He said my questions provoked him to be frustrated and he felt his anger rise about the current situation that’s why he had to leave.” – interview observation notes

This frustration stemmed from the successive failures of decision making on economic policy:

“The country moves out of sheer inertia. You don’t feel the presence of the government or their initiatives moving the economy.” – private sector 1

The country still hosts a high level of protectionism and barriers to trade with government playing a pivotal role. An interviewee saw the two sides to this protectionism – protection of the country’s industries inhibited growth but also ensured social sensibilities were being catered for:

“Companies that operate here are vulnerable to very politically-risky judgements. When investment is opened to outsiders, you favour removing barriers to entry as soon as possible in politically sensitive sectors. I am not an absolute believer in justice meted out by the invisible hand but there’s the social sector [and social impact] to consider when you open previously closed sectors to external ownership and investment.” – private sector 2

In its failure to act as facilitator for economic development, government is seen as a hindrance, with the hands of the private sector largely tied by its public sector counterparts. Some private players have filled in the institutional void left by government providing support for Chung’s (2005) thesis on business groups:

“Government is failing internally for example in education, mining. Eventhough it’s not the job [of the private sector], we provide schooling in the communities that we are in.” – private sector 3

Unlike other countries in the region, private sector led economic growth is yet to take off

in the Philippines. Government constraints are related in the next section and how regulation in the country is largely politicised.

4.2.2 Politicised Regulation

The pervasiveness of political decisions has a profound, integral and immediate impact on the private sector and its regulators. The lack of autonomy in decision-making by regulators means informal relationships, hierarchical decisions and political patronage are issues that policymakers and businesses must contend with in order for the latter to exercise their authority and for the private sector to operate successfully in the country. Various newspaper editorials during the course of my fieldwork suggested improvements in government's oversight of the private sector to instil confidence and diminish unpredictability. The following excerpt from a Business Mirror editorial encapsulated where governance fitted in:

"Even more important is upholding good governance so that the private sector sees engagement with the government in the noble enterprise of economic development and nation-building as worthwhile and necessary. Corruption begins to rear its ugly head whenever development projects are announced by the government, but as they say, it takes two to tango." Business Mirror (2007c)

Several interviewees (including one regulator) spoke about politicised regulation in the government bureaucracy as hindrance to economic development:

"...we have to be realistic. We have to operate here with this government...As a businessman, the bureaucracy, the corruption, the politicking involved [is frustrating] – I refuse to have any dealings with them." – private sector 1

"Economic development [in the Philippines] is tied up with politics." –private sector 2

"The political infrastructure of government is stifling and it's a hindrance to economic progress" –regulator

Echoing past experience with a predatory government, elements of crony capitalism still continues today in the Philippines especially in regulated industries. Successful reform

initiatives largely depended on the extent protectionism and favoured players are in the sector:

“No, the [government] has not been effective. They have paid lip-service. They have attempted to do certain things and it depends on the sector. Regulation in banking and finance has been the most successful for a variety of reasons as the financial community is globally integrated with Basel requirements and that’s the name of the game for that sector.” – private sector 3

“[There are] heavily regulated industries in this country in areas of infrastructure: water distribution, airlines, ports management. The incentive of [operations in] these industries is in regulatory capture. These are regulated industries. The culture of rent seeking is to capture politicians, to capture the decision-making so you’re not accountable.” – private sector 4

Politicised regulation damages the bureaucracy and contributes to eroding public confidence in government. Politicised regulation also contributes to inefficient allocation of private sector investment. On the public sector investment side, Chapter 8 looks extensively at how government pension funds – the country’s main institutional investors – are guided not by their mandate but by the whims of their political overseers.

4.2.3 Politically-Connected Firms

Within the private sector, the reality of dealing with the politicised environment means players are faced with the spectrum of choice from reluctance to whole embrace of the sometime unsavoury aspects. Incentives for a business to be well-connected politically in order to operate show the challenge of doing business in the country without involving government officials. The nature of one’s connections comes down to a matter of organisational values for the firm involved. The reality of operating in the country means a certain compromise must be reached to ensure the continued existence of a business:

“Every businessman would like to see ethical conduct similar to the initiatives from the private sector. In the private sector, we practice good ethical conduct. It’s a difficult scenario [as you have] to compromise your values.” – private sector

1

A two-tiered private sector has also emerged. One tier operates trying to avoid influence-

seeking in government, while the other tier realises their core businesses cannot operate without influencing politicians:

“There are some big legitimate businesses versus some big guys who are playing another set of rules. Our hope is the latter become ethical players and become ethical. While in the former the big players exercise CSR and not take advantage of their premier position and market power. The problem is for these legitimate companies they are forced to behave unethically [to compete].” – private sector 2

“My [interviewee] was president of [a public sector] board and promoted [a liberalisation policy] which went against the interests of a politically connected person. The President of the Philippines needed this person’s support so [my interviewee] had to leave his position. According to my interviewee this person has bought so many congressmen and the President flipped-flopped her support for my interviewee. This person published a full page newspaper ad calling my interviewee a traitor on the liberalisation policy. My interviewee is currently in his position as there were people who supported his stance.” – interview observation notes

For one regulator, interacting with a politically connected private sector owner is a source of frustration:

“To [name of politically-connected person], just stop complaining and just do business. Just do your work. If you run into a problem and you don’t want to cough up anything, that’s what you get. You’re buying decisions, buying people. Some people just complain.” –regulator

Some interviewees criticised the sometimes ‘unethical’ players for contributing, and in some cases, compounding the weakness of the government. When private sector participants interfere in the politics of the country, unintended consequences occur:

“It’s all about the right connections for example if you look at the cigarettes sector. It’s not a level playing field. There is not free and fair competition. They want government they can dictate even if the cause of that is instability in the country. They looked the other way when the President cheated because the contender was not part of the elite. They are now reaping the consequences of this choice.” – private sector 3

“A lot of companies don’t practice accountability and transparency. The SEC and PSE need to have the resources to enforce stricter rules in accountability and transparency. [Name of a person] is one of those people who don’t practice corporate governance.” – private sector 4

The annual State of the Nation Address (SONA) made by the President is a signal to private sector participants whether their projects (if mentioned) will go ahead (or not). If it did not get mentioned, then it will never get off the ground:

“Certain projects in the State of the Nation Address (SONA) require strong political support. These projects would not have passed if it didn’t get political support.” – private sector 5

Attempts to insert some independence in a public sector office are sullied inevitably by the connections of the recipient as in the following case of an ombudsman. The connections of this person mean any perception of his independence is marred by how he came about to be appointed:

“There is an ombudsman and it’s supposed to be an independent position but it’s a political appointee by the President. The present one was a classmate of the First Gentleman at law school. [So people think] it’s the influence by the First Gentleman on how the ombudsman got appointed.” – private sector 6

The legacy of the Marcos years has also meant unravelling the culture of rewarding politically well-connected firms. Under the rule of Marcos, the dictator’s favourites received the spoils of patronage with supporters receiving board memberships:

“For example, government corporations were sequestered during the Marcos era with their own boards of directors.” – private sector 7

“Under Marcos, big names in the political arena formed alliances with his cronies and they became the new elites.” – private sector 8

In doing so, Marcos’ actions divided the private sector by pitting one business group against another and this has created a long-standing distrust of government with the enmity remaining today.

4.2.4 Calls for Public Sector Governance

For governance reforms to gain wider legitimacy and acceptance, several interviewees called for improved governance in the public sector to complement private sector reforms. The lack of reform in the former leads to a credibility gap. The introduction of corporate governance has prompted calls for similar reforms in the government sector. In a public governance conference held in 2007, the PSE CEO Francis Lim encapsulated this public/private sector diptych on Philippine corporate governance:

"Governance is not just the responsibility of the public sector. It is not just the responsibility of the private sector. In other words, it's a shared responsibility." – Lim in Estopace (2007)

Most interviewees were articulate in what they saw were problems in the public sector that affected the way they did business:

"Government must lead by example. It affects us in the private sector. Whichever standards we use, we can't do it just by ourselves. I'd like to see public sector corporate governance. It is a key driver for corporate governance integration in the way we do business. Family firms have now the tendency of going public and that will help strengthen the private sector." – business group 1

"Corporate governance when it comes to private sector entities is equally challenged by the lack of corporate governance in our counterparties in government. Entities we're dealing with such as the BSP, SEC, are already at that levels. I don't believe in the peddling [of influence] in this system of government. [Government] should be the first one to implement [governance] as in the private sector. It's a system of nepotism here." – private sector 1

"The real problem is the national and political governance. Thankfully, the [corporate] regulators have been good. But we operate locally so we need the government for a whole host of things. There are all very basic reforms that are needed." – private sector 2

Private sector corporate governance requires complementary reforms in the public sector. The future of private sector development relies in that sphere. The following two comments best articulate the problems the country faces:

“...corporate governance cannot be isolated from other forms of governance such as public governance. The public governance in the Philippines is not the best in the world. There are broader public governance issues as well. If we get corporations to behave and they don't see the consistency on the public level, it is a disincentive. We cannot look at corporate governance in the Philippines independently of public governance issues as well. We recognise dealing with governance reform on the national level is not impossible but it is a big challenge. On governance we can take as much as we could and there are grounds gained. The glass ceiling [needs to break] on public governance and the governance of state-owned corporations as there is some political baggage and inefficiencies in that sector.” – private sector 3

“The future of corporate governance in the private sector depends on the public sector. You can't simply disregard the effects of public governance. A major stakeholder here is government. You look at government, the regulator – the performance of any of the private sector companies is affected by support from the public sector. This is the environment where you operate. The public sector also needs to develop its own governance standards to attend and contribute to the growth of corporate governance in the private sector. Governance of the public sector in countries is successful because they have mature government institutions and the government develops their public sector.” – PLDT

The main stumbling block – that of politics – can be unsurmountable in the current environment for effective public sector governance to take place. A culture of active regulatory enforcement throughout the rest of the government bureaucracy and not just the main financial regulators was strongly wished for:

“We need to have complementary reforms in the BIR and the other regulators. It cannot be [just the private sector].” – private sector 4

“Greater transparency in the regulatory environment of both government and self-regulatory bodies like the PSE will contribute greatly to improve corporate governance in the Philippines. Of course, more transparency should also help control the culture of corruption prevalent in developing countries.” – business group 2

While for the most part the corporate governance regulators (see Chapter 5) are held in better esteem than most, some interviewees had problems with their industry-specific regulators:

“In a heavily regulated industry such as the telecoms, so much depends on the National Telephone and Communication Commission [I asked if I should contact them on governance but they said they won’t be useful on this point]. Telecom industries here are regulated - it important to address the certain limitations and weaknesses of the regulator.” – private sector 5

“We are also monitored by CHED - the Commission on Higher Education. CHED is another government body monitoring us. If I were in CHED, I’d do more...they took back their word when we limited our tuition fee increases. When they issued [an edict] on tuition fees, we followed it to the letter (but they later reversed it). We’re glad there’s no problem on our part to do this.” – private sector 6

To give credit where it is due, the public sector side is heavily influenced by the concentration of power in the executive. Both public and private sectors recognise that there lacks strong, autonomous government institutions in the country primarily because of the high degree of political influence exercised by the executive at all levels of bureaucracy (see Chapter 8). The Westminster model of a strong bureaucracy working independently of the politicians as personified in the UK TV series “Yes Minister” does not exist in the country. The bureaucracy suffers major upheavals every time a new president takes power in the country. Such is the concentration of power and decision-making in the executive – which is embedded in the country’s constitution – the temptation is there not to relinquish the position voluntarily. Indeed, in a one off-the-cuff moment when the then UK PM Tony Blair resigned from his office in favour of his treasurer Gordon Brown, one of my interviewees observed:

“That [peaceful] transfer of power would have never occurred in this country.” – private sector 4

How this concentrated power affects the government bureaucracy is palpable with the ability of the executive to appoint and dismiss heads of departments autonomously. One regulator pointed out the way the presidential appointments system works makes it

difficult for lasting governance reforms (such as independent director appointments) in the public sector to occur:

“How can we have independent directors if everybody gets appointed by the country’s president? The president has enormous power relative to appointments and the president does recognise that there must be good corporate governance. The president believes good corporate governance must prevail be they public (government-owned) corporation or else. It is difficult to change the culture but we have to start.” –public sector

The public sector is bigger than the private sector of the country. There are more government owned corporations than there are listed companies on the Philippine Stock Exchange with 736 government owned corporations compared to 241 listed companies.³¹ The appointments system in the country is vested in the President and changes to this system require legislative reform to make independent board appointments on government-owned corporations.

Public sector reform is far more relevant and of greater import. A common sentiment amongst my interviewees is that a strong private sector in the Philippines requires an equally strong, non-politicised public sector. The private sector is small and the widely influential OECD principles of corporate governance have been imposed on it yet there is no similar reform in the public sector. In 2005, the OECD issued Guidelines for Corporate Governance in State-Owned Enterprises. This is an acknowledgment of how corporate governance reforms in the private sector are shaped by the large public sector in developing countries such as the Philippines.

Reciprocal reforms in public sector governance to complement private sector reforms will enhance both sectors’ capabilities and gain wider legitimacy amongst the general populace.

4.2.5 Role of Government

Areas of public finance, opening up protected industries and having a level playing field were mentioned by interviewees as necessary for government to address in order to improve private sector development. There is a wish for government to be the referee of

³¹ See Slide No. 12 from Moreno (2006) and “as of 1 May 2007, the Philippine Stock Exchange has a total of 241 listed companies” from PSE (2009).

a level playing field and to enforce the rules consistently. This would create an environment of certainty and predictability which business favours:

“I’d like the government to open the economy up. Competition isn’t at all possible by itself. You need regulations and regulatory authorities. For example with the stock market, it is a free market but it has to be bounded by a lot of rules so there’s a level playing field so there is no insider information trading and full disclosure is made. [It’s hard to be deceitful] with free markets and competition with good regulations.” –private sector 1

“Opening up the economy helps with the liberalisation of reforms. Under Ramos, PLDT, water, telecoms and banks were opened up. Opening up protective industries resulted in robust reform.” – private sector 2

The problems of the public sector are a reflection of the quandary of the government of the Philippines. As the operational arm of government, the bureaucracy is affected by the caprices of the executive. The pervasiveness of government and its tendency to control has impeded the development of the natural entrepreneurship of people. Referring to the economic policies of the past, one interviewee pointed out the devastating effect they have had on the country’s private sector development:

“The whole of GOCC requires reform in its legal personality. All GOCCs should have a prospective charter. Look at the corporate governance of the GOCC and change the whole system. Pure capitalism or what it should be is people don’t act in their own self-interest. The pure capitalism model here is what the role of government should be if it happens. If there is less government, you achieve things more simply. For example if government is only occupied with social welfare measures and you deregulate the rest and open up the economy - why couldn’t it happen here? Is it completely different? Government can get out of many things. They have major interference.

“True economy subsidisation doesn’t work. They are trying to have the capacity to control, and the unintended impact spreads through. This is where politics, oil and food make it very difficult to reform the sector. You need to get government off there. Subsidies on food and oil benefit the rich and they’re not targets at all of the subsidies...there is a natural inclination to compete in people and they can’t

compete. These are frustrating times. Here, you can't get politics out of the way; politics doesn't allow that to happen...There is too much worry about the politics. Government involves itself where it should not be involved. It becomes personalised and political...if oil prices increase, the people starve. The government can introduce social welfare measures but [try as it might] the government can't control the economy, it can't control impact. There is no confidence in the entire country.” -private sector 3

Indeed, the thriving informal sector in the country shows it is not ingenuity, business nous or entrepreneurship of Filipinos that is inhibiting its development³²:

“The culture impacts on how government is involved and it is involved in far too much. It's inhibiting the natural competitive behaviour. [The country has people] who have had capitalist success and done extremely well. They are widely respected.”- private sector 4

While in practice government is far too ubiquitous, the policy formulation has now taken a more enlightened approach with a mindset towards less involvement of government. The following passage from the then Finance Secretary, Gary Teves, sets out the limitations of government in future national economic activity:

“The principle is, we believe that in most cases, all other things being equal, the private sector can operate most of the corporations or establishments where the government has some stake - they're better left in private hands. And we believe the government should concentrate on its core business. And that's to concentrate on providing social services and infrastructure. It will be very helpful if the government were just to concentrate on this core business and let the private sector do the rest. But as we do this, what's also very important is that we have a good sense of our approach on regulation. It has to be a regulatory body that will combine enforcement with a sense of the market.” - Business Mirror (2007d)

The above passage also reflects the limitations to future reform in the country. It is not up to the Finance Secretary to set in motion these overall macroeconomic reforms but

³² Entrepreneurship in the informal market has been a source of study such as Morris and Pitt's 1995 study of entrepreneurialism in South African townships and Morris et al (1997) linkage of entrepreneurialism in the informal sector with economic development.

the politicians that can and do make these happen. Political will is the crux. The instability and unpredictability of leadership in the politicised bureaucracy affect the ability of private sector participants to make long-term decisions (see Chapter 8):

“It’s very developmental. A lot of areas need improvement such as public finance. It really is a question of political will if reforms can be implemented. Year in year out we have the same complaints.” – private sector 5

“It’s investment-given that [implementing reforms] are to do with culture. It also has to do with political will. The political ingredient is essential. When you make the rules, you naturally affect the whole scenario.” – regulator

Or as one hopefully suggested, looking to outsiders to force change on the country, liberalise and let it join the rest of the world:

“Throw out the politicians – they can freely politicise other institutions. The countervailing force is the international market as they demand certain levels of good governance. The financial markets want that but that’s short-term. In the long term, change the constitution, allow foreign competition [and remove] foreign ownership restrictions, [so there’s] competition in media, telecoms and service industries.” – private sector 6

The frustrations felt by my interviewees lie principally due to the problems that have readily available – but politically sensitive – solutions. The problems are widespread, but the solutions are also well-known. Conflicting interests of politically-connected individuals, families and companies make reforms difficult to implement. The next section briefly looks at political dynasties and their role in the political infrastructure – and fabric – of the country.

4.2.6 The Philippine Oligarchy: Political Dynasties

The oligarchy is a feature of Philippine socio-economic life. One explanation of the political sluggishness to motivate reform has a lot to do with the interests of political dynasties that dominate the country:

“There are vested interests of the families that control the economy and politics. It goes right through the whole of organisation within this country. It starts on

the senior level of the President. Selected families are involved in the politics. Look at the candidates, they're all interrelated. The politicians within the Senate and Congress – they are handed from father to son. The unions here – major unions are controlled by [this person]. He's the president and he just handed it to his son. That's the way things work in this country.” – private sector 1

While it was beyond the scope of this research to explore further the role of political dynasties, several interviewees mentioned their importance in understanding the operations of the country. A regulator suggested I read a book called *The Rulemakers* which looks at political dynasties. The book was written by members of the Philippine Centre for Investigative Journalism (Coronel et al 2007) and documents how 70% of members of the Philippine legislature are related to each other. In a country of 80 million people with a purported democracy, at face value it is difficult to understand why wider representation is not available and why political seats are handed from one family member to another:

“Due to the political oligarchies in the country, bills are passed to protect one politician. There are political families that are generational: wife, widow of sitting member; they are sitting until the next generation comes along. It is not a matter of merit on who becomes a politician but on who they know. If they know a person who is well, they tell another person, until it spreads that they are a good person and that is how they are voted.” - regulator

The dominance of family-owned business groups in the private sector is mirrored by the clannish nature of Philippine politics. A few families dominate the private sector and equally a handful of families dominate the Philippine political sphere. According to one interviewee this meagre representation breeds a high degree of inequality:

“Certainly there is an uneven playing field. This remains a serious problem.

Family-based form of economic power translates into familial politics.”- academic

A quick solution to the political dynastic problem is far from immediate. One offered the perspective that the reality of dealing with political dynasties means some pragmatism must be observed. This includes appreciating that a member of the political family would have the best exposure and in-house knowledge of how to navigate best through the complexity of Philippine politics:

“If I were to choose a governor in my town tomorrow, one from academe or one from a political family; I would choose the one from the political family. That person would have had political training and governance started in childhood. That person would be living politics and government every day and exposed to a lot of practical training. An academe doesn’t have that. [A political family member would be] used that to that...[The Philippines] is an exciting place, not a dull place.” – private sector 2

Another defended political families and their tendency to interact and marry each other, thus propagating the elitism:

“[On dynasties] and oligarchies in politics, in business, sure they exist. Wealthy families marry each other. In politics, the oligarchy is a sure thing. People who interact [in the same circles] become attracted to each other. I’m not sure if dynasties are more of an issue of governance and whether they are a deterrence to governance. It’s not their fault if the families [have reached where they are] it’s public governance awareness that’s hurting the country more than families.” – business family member

Another interviewee called for overall reform such as disestablishing their hold on Congress. However, the current state of the concentration of political power means members of political dynasties are wary of losing the power that they have accumulated over several generations. The sense of entitlement to a Congress seat means political families will be reluctant to lose power without receiving something in return for any loss of influence and prestige:

“We need political reform but we have to break up the dynasties. Congress does not have the commitment to pass laws to break up dynasties. Maybe we need a revolution. Can it be done peacefully? We almost had the opportunity in 1986 and it was a revolution. The old order changed, but the new order inherited the old order’s corruption and kept it.” – private sector 3

The intergenerational representation in government of political family members has institutionalised the process. If changes are to be made, these political dynasties need to be co-opted. Clearly the way democracy is governed in the country is dysfunctional but whether the change of the political process will provide a solution to the problem is

another issue altogether. Indeed, how is it possible to implement political reform within the pre-existing oligarchical structure? Political families are both the problem and solution according to the following passage:

“You have to take the family seriously. You can’t put decisions to argue that the political families are a hindrance to modern institutions may lead to the failure to examine how to move away from that form [of dynastic politics]. You have to understand families: their recruitment, financing reforms. There is a huge concentration of wealth. Start where you are. Start with the political families. New generations are socialised and groomed to take power with a different socialisation. There are a lot who are tired of the same families. There is a situation where the Western institution in the political and economic arena is imposing on a highly concentrated, unequally economic and political structure. If you move to a parliamentary system, you’ll have local oligarchs. It goes hand in hand with institutional changes, address the inequality first. You can’t move from A to B (congressional to parliamentary) without understanding the familial control. Reform, the possibilities of reform have to start with that. There’s a certain level at which some of the [corporate governance] principles allow us to challenge the corruption and control of families.” –academic

As the earlier section on culture in this chapter pointed out, the centrality of the family in Philippine culture is reflected in the dominance of this institution in political and business spheres. However, that other trademark of Philippine culture of insularity outside the collective provokes exclusivity. By their nature, families have a natural limitation due to extant blood ties. We cannot all be closely related to each other. Therefore favouring a family member simply because of their connection has had unintended and unfortunate consequences as outlined by my interviewees above.

By any measure, a country nearing 100 million people is ruled by an oligarchy where 2/3 of the politicians are related to each other is hardly representative of the population.

4.2.7 Democracy or Dictatorship?

The ineffectiveness of the political process to affect economic change in the country was a major concern for interviewees. At stake were issues of pride, nationalism and a sense that things can be so much better for the country if the political machine could be

effective enough to contribute to overall national development instead of continuing the entrenched power of political families. The sense of failure in all levels of government was a reality most were dissatisfied with manifesting itself with little confidence and trust in the efficacy of government:

“We claim to be a democracy, how practical is that? In this election? Influenced by other factors?” –private sector 1

Some observed there was a high turnover of politicians who have not sustained more stable patronage; therefore this places more ‘worthy’ candidates in a bind:

“Government can do a lot, but will government? They have not done much. At the local government level there are term limits but even good local officials experience a lot of turnover.” – academic

“The official figures of GDP growth aren’t true. They are borrowing more than they are stating. There is a looming crisis. There are 4 ministerial positions unfilled. It’s like a revolving door. [Cabinet] secretaries come and go, for example if the Minister of Trade has a falling out with the President. In the Philippines, it is very uncertain. There is no continuity or consistency in the ability for the organisation such as ours to establish a long-term ongoing relationship with the secretaries. We need to first establish stable relations [with government].” – private sector 2

Several discussions I had with interviewees felt that to overcome the inefficiencies in government, a strong dictatorship would be sufficient to get back the country on its feet. Some spoke of the early days of the Marcos dictatorship when there was ‘order’ with people queuing and not the chaos that dominates government policy and decision making of today:

“They need a revolution or a dictator by the scruff of the neck. Just change it, change the constitution to a parliamentary system. But they’ll go through pain before we get to that.” – private sector 3

“The Philippines has always been influenced by geopolitical events. No possibility of a coup yet. But the trend has been reversing democratic gains with high oil

prices but we could have a dictator like [Venezuelan President] Chavez.” –private sector 4

“When Marcos declared martial law in 1971, that was an ‘opportunity lost’. People were following the [orders] given. [However] power corrupts.” – private sector 5

And in that last statement I exchanged with the interviewee the maxim that absolute power indeed had the tendency to corrupt absolutely.

Another interviewee pointed out that many were seeking solace in religion as way to counter the disappointment and despair in the country. In the Philippines, there are mass religious Christian movements, unattached to the dominant mainstream Catholicism in the country. This religious movement was a metaphor for a greater search for spirituality amidst the futility felt by people in a corrupt system and government. These religious movements have also become political forces in their own right:

"Currently, the Philippines has gone to greater spirituality with the spiritual movements. It is a reaction to the lack of trust [in government] since they can't do anything in the system, they invoke supernatural forces. That's why these are political forces now e.g. El Shaddai and Villanueva harping on the lack of values in government." – private sector 6

One regulator called the country as being the ‘pariah in international markets’. And indeed, the rest of East Asia had moved on in their developmental stage while the Philippines is seemingly stuck in a quagmire:

“Look at other Asian countries. 20-25 years ago we were ahead of Taiwan. When I hooked up with Arthur Andersen I was very happy with a Philippine salary. [The peso was] much higher than Taiwan. Right now, it's different, you work in peso in Taiwan you are dead.” – private sector 7

Advocates for a stronger state frequently mentioned the example of Lee Kuan Yew's Singapore:

“...there is too much democracy in the country. Marcos tried to change it but he was ruled by his wife. Malaysia, Thailand, Taiwan did not have so much democracy. Look at Singapore it is run like a family corporation. Quick decisions

are made. Here in the Philippines, there is too much democracy.” – private sector

8

“Why is the Philippines left behind? There is too much democracy. In Singapore you have Lee Kuan Yew. Five years ago he came here and said “You Filipinos are crazy. You’re going the American way, emphasising human rights, democracy. What do you have compared to the USA? You are far apart [economically]. If you look at Lee Kuan Yew, they throw you out of Singapore [for doing petty things].”

– private sector 9

The path to return to a Marcos dictatorship redux is not without its supporters. If the country were to return to those days, at what price will the country have to pay for another dictatorship? Asking an academic if the country could afford another bout of dictatorship, his response criticised the short-term memories of people:

“Advocates of authoritarianism forget that the Philippines went through 14 years of martial law with negative results. The problem is that in an oligarchic patrimonial state-society structure, authoritarianism leads to further concentration of power. Note that Davao, Marikina and Singapore are all cities. You can’t rule a whole diverse country the same way.” – academic

The Philippines tried dictatorship and it did not work. However, the current democratic regime it is under does not seem to bring the long-awaited benefits of development. Where during the period of dictatorship, the responsibilities of progress (and failure) lay principally in one decision-maker; the period of ‘democracy’ the country is in means that many are to blame for the failure of the country though none seemingly wishing to admit to this (collective) responsibility.

Disappointed by several presidents, the Philippines’ failure to take-off has disappointed many. Neighbouring Indonesia, which recently toppled its long time dictator Soeharto, is progressing and advancing economically and even its democracy is regarded as more functional than the Philippines. Vietnam, after the shackles of war, has embraced market liberalisation and undergoing a path of development not so dissimilar to China. Will greater economic and political integration through ASEAN save the Philippines the way EU membership for Spain paved the way for that country to cast off the remnants of dictatorship? For the moment, ASEAN’s embryonic steps towards regional integration is

just that, nascent. Democracy is not widely embraced in the region. As one interviewee pointed out the Philippines expects an outsider to save the country yet only the country can save itself. Internally generated reform will have the most legitimate form of change rather than an externally generated one.

The political environment in the country continues to be fundamental to the way business operates. The political environment shapes, influences and motivates how the private sector behaves, while the general public react to unpopular political leaders with discontent through public displays of protest. The political environment of the Philippines will continue to be a challenge to all actors. The heavy hand of the state dominated by a few well-connected players has thus far meant severe social and economic inequality. Ruling families, not bureaucratic elites, dominate the country. For now they shape the country's present and near-future.

4.3 Background to Corporate Governance Reforms

Whereas the previous sections mentioned the prevailing conditions in the country, the latter half of this chapter looks at the formal introduction of corporate governance in the country. In order to answer the main research question motivating this research, "what is the impact of corporate governance reforms in the country" it is important to narrate the background to the introduction of these reforms and subsequently the impact of such reforms (which are explored in later Chapters).

The main events that shaped the introduction of corporate governance in the country were the East Asian Crisis of 1997 and the collapse of Enron in 2001. The corporate governance responses to these events were the OECD Principles of Corporate Governance of 1999 which was substantially motivated by the defects that were systematically exposed in the East Asian Crisis, and the US Sarbanes Oxley Act in 2002 which was a regulatory response to the blue-chip collapse of Enron.

This section also provides supportive evidence of my first hypothesis:

H1: Post-1997 corporate governance policies in the Philippines will exhibit similar ideas contained in Western principles of corporate governance

Whereby, Western principles of corporate governance, and the ideas contained therein, were incorporated in local, Philippine corporate governance principles.

This section primarily addresses the following question:

Why were corporate governance reforms introduced into the country?

In order to answer this question, the background of the reforms by narrating the different corporate crises, the motivations and the influences of different institutions are explored.

4.3.1 Impact of East Asian Crisis (1997)

The East Asian Crisis of 1997 had a less severe effect on the country than its neighbours. Why this was so was largely due in part to the fact that the Philippines was overlooked by foreign portfolio investors relative to other East Asian countries. The Philippines had also suffered a debt crisis during the 1980s which affected other Latin American countries at the time but did not affect other East Asian countries. In short, the Philippines was not as an attractive foreign investment destination as other countries in the region.

Capital market speculators were less inclined to find the country as attractive for their investment. And when these same fickle foreign investors were spooked by the wave of debt hampered by currency devaluations during the crisis, these investors quickly removed their money. As the Philippines received less money from these foreign investors, the impact was less severe and arguably, did not provide the big impetus for structural changes that affected Thailand, South Korea and Indonesia:

“We came to the party too late, we didn’t catch the fire. We didn’t do what needed to be done because there was no urgency in the post-crisis reforms. We didn’t fall as bad, but neither did we pick anything up to get back on track.” – lobby group 1

On the Philippine Stock Exchange, several listed companies - who were structurally vulnerable and were funded weakly - collapsed:

“BW Resources turned to the PSE to raise money but it was essentially a conduit. The Ramcar Group was a conglomerate of food, auto accessories. These companies come to mind as being immediately impacted by the East Asian crisis. They weren’t big enough to make headlines. Philippine corporations are small

compared to the regulars such as the First Pacific Group. You don't hear too much about these small companies." – private sector 1

Yet, the crisis did still have an impact on the country:

"On the East Asian Crisis, of course the crisis had an impact. It didn't impact as bad in the Philippines as Indonesia and Korea but there was the large scale intervention on behalf the IMF. It affected the Philippines. You had a situation of a number of large corporations with mismatch borrowings, USD liabilities, funding amounts matched with revenues stream." – private sector 3

For the main part the East Asian crisis provoked a great deal of awareness on corporate governance:

"In terms of the family structure, the crisis did not affect [business groups]. It just raised the awareness. [The system here] is family concentrated as far as practice is concerned." -academic

"The East Asian Crisis triggered an awareness in part of corporations in the Philippines and the regulators. There was a need to institute corporate governance." – Ayala

"The crisis affected a number of companies and they were awoken to raise corporate governance standards. The crisis was pretty obvious in that it created a lot of awareness and value of corporate governance. The Philippine market is dependent on foreign capital. The source of capital outside is foreign banks and foreign financing. They are aware of corporate governance. It is important for Philippine corporations to be able to access foreign capital. [The standards of corporate governance] affect the borrowings of Philippine corporations. It's [these standards that act like a] barometer of making a decision [on whether] to extend credit to Filipino corporations. During the crisis, the Philippines was one of the 4 countries blacklisted by foreign investors. Corporate governance is imperative to raise standards." – PLDT

Thus for other companies who survived the crisis, they took the opportunity to restructure in the post-crisis environment:

"There were serious governance issues in 1999 reeling from the East Asian crisis

which highlighted good corporate governance of corporations was necessary and that corporations couldn't remain closed shops.” – ICD

In the aftermath of the crisis, the first release of the OECD Principles of Corporate Governance provided the impetus to introduce and improve corporate governance in the region and elsewhere.

4.3.2 OECD Principles of Corporate Governance (1999)

The 1999 OECD Principles of Corporate Governance were promulgated a mere two years after the East Asian Crisis. They were a direct response to the East Asian crisis. The principles provided the opportunity to solidify and establish proper corporate conduct and they recognised the importance of well-governed companies to societies. Similar to other countries in the region, the importance of the OECD principles is carried out through the formulation, implementation and application of corporate governance in the country. Chapter 2 looked at the influence of the principles and responses to their widespread adoption.

4.3.3 Enron's Collapse (2001)

While the East Asian crisis exposed the vulnerabilities of growing economies in a financially globalised world with poor institutional foundations, the impetus that provided the mindset and substantial motivation to introduce corporate governance in the country was the collapse of the US energy giant Enron. Soon after, the collapse of WorldCom happened. As auditor of both Enron and WorldCom, Andersen survived the failure of Enron, but did not survive the latter – its reputation could not handle under scandal and by then had lost legitimacy. Within a short space of time, three giants of American industry had failed and disappeared. The impact of these collapses were profound - if a then highly-esteemed corporation like Enron could implode so spectacularly in a short period of time, corporations in other countries such as the Philippines can face the same fate and as easily be affected.

Enron is now used as a case study in the Philippines on the warning signs of a company that supposedly ticked-all-the-boxes in corporate governance, yet the substance underlying the company form was sorely lacking. The story of Enron helps corporations understand why corporate governance must become part of doing business. Attending a

corporate governance workshop for mid-size companies, the use of Enron as a warning for business was explained as thus:

“Government and regulators want this corporate governance workshop to be undertaken by all directors. Imagine [Lucio] Tan, Ayala Group’s JAZA going through these workshops.

“Why must we have corporate governance? Because it is expected by the international community. A country that is perceived to practice poor corporate governance won’t receive much FDI. We’ve been in that category for many years. We have our own Enrons in this country and we need to restore the reputation of business for everyone.

“Why do we use Enron? Because it contains the recipe for bad governance and is the ultimate collapse. For the last 5 years we’ve presented Enron. The material is still appropriate. Enron was the mother of all scams. It is the most catastrophic collapse in world history and its existence had many ingredients of bad corporate governance. There are some similarities to some Filipino corporations in being ‘photogenic.’” –CG workshop

Enron’s once-highly regarded risk management system in place proved to be grossly ineffective:

“When we were trained in risk management, we were taught the version of Enron’s risk management. Even with the risk management structure they had in place, the company still collapsed. Enron in the Philippines was audited by SGV/AA. Enron was just engaged in ‘intelligent gambling’.- CG workshop

Similarly, Enron’s complex corporate structure came for some scrutiny:

“We use Enron as an example because it was the preferred placement for Harvard MBAs. Brian Gruber was hired in the year’s collapse and he wrote a lot about Enron. It had a complex corporate structure with 3,000 separate entities including 600 in the Cayman Islands. How can we consolidate a company with 3,000 separate entities in different parts of the world with different deadlines?” – CG workshop

Enron’s engagement with complex financial transactions is reminiscent of the failures of

financial institutions during the GFC and their engagement with credit-default swaps. Indeed the crisis of 2008-2009 showed little had been learnt from Enron's foray into derivatives:

"By 1997, Enron had lost its core competence being involved in weather derivatives. They were trading 'credit risk' ever heard of this risk before? The Enron units were working independently of each other. The organisation was flattened." –CG workshop

The behaviour of Enron's board was also scrutinised. Firstly on the short-term remuneration orientation of its members and the unethical behaviour engaged in order to achieve the former:

"The board also had bonuses, options based on market value. Keep on as they would improve by showing good returns. The objective to Enron is properly made up and projections from the market. There were four core values of Enron: Respect, Integrity, Communication and Excellence (RICE). They had a code of conduct which expressly prohibited from obtaining personal gains. But this prohibition was waived by the CEO (also the Chairman) who said that as long as the funding arrangement was not adverse to the company then the Chairman can negate the code of ethics and do away with it." – CG workshop

The culture set from the top filtered down to the bottom. While the board was not explicit in its approval for a short-term value orientation, it was perceived to be implicit:

"Business plans were prepared by management and they were responsible for achievement of the plan. The plans required the approval of its responsibilities were with the board. The business units were competing against each other. Its profitability was based on multi-Level marketing. It is always good investment to have long term investment financed by long term borrowings as the income is regulated. For Enron, its investment rating went down if [short-term] profitability is not sustained. Enron sold off many long term investments. Enron was an asset light company and the assets were concentrated in a few. –CG workshop

As another interviewee pointed out, substance - not form - in corporate governance counts:

“The Enrons of this world with trophy directors, heavyweight directors - even in developed countries, the corporate governance principles were not being followed. Solid reputations proved to be unfounded. Corporate collapses are not the monopoly of the US as it has also happened in the UK, Australia.” –private sector 1

Finally, workshop participants were posed the following rhetorical question:

“Do I sit on the board whose company operates like Enron?” –CG workshop

4.3.3.1 Impact of Collapse

The psychological impact of the Enron collapse on Philippine corporations provided the bigger impetus for corporate governance reforms in the country. The following comments show the impression Enron’s disintegration made amongst interviewees:

“There is a gap between the East Asian Crisis (1997) and Enron (2001). It was after Enron that there was great concern about corporate governance. If it could happen in the USA – that bastion of capitalism – it could happen anywhere. After Enron, there was a rush into introducing guidelines. Rather than waiting for other collapses to happen locally, there was intent to do something about. If it could happen in the USA, it could happen to big Philippine corporations. Enron is suppose to be the model of risk management. It was the envy of the business community with risk management as it could do things so efficiently, even managing weather risk. Its collapse was monumental.” – industry association

“Things were slow [in corporate governance] as the Philippines wasn’t as affected by the crisis but then in 2001, Enron happened. Corporations looked at the ICD again with new eyes and asked about corporate governance: “We better do something about these governance things” before we become the next Enron.”- ICD

“It wasn’t until after the Enron fiasco that the Philippine Securities and Exchange Commission (SEC) accelerated efforts to put good corporate governance standards in place, and Benpres complied with the good corporate governance requirements.”-BPH

“For shareholders there were corporate governance reforms in 1997 after the

crisis) But really [corporate governance happened] from 2002/2003 – starting from Enron.” –public sector

Other interviewees mentioned Andersen’s collapse motivated corporate governance reforms into the country:

“In governance [in the country], the reform is principally the SEC Code of 2002 and that was the result from external pressures. There was a crisis in the US, the Enron Scandal. Earlier than that was Andersen.

[discussion of why American scandals should affect the Philippines]

“Well we kind of had an Enron situation here with the local affiliate with SGV – the largest auditing firm. It was found they were cooking the books, allowing the clients to lead them instead of auditing. There were a few companies that had lax accounting. It was not as dramatic as Enron but there were some pretty big companies that were involved.” –private sector 2

“My impression is that corporate governance would be more an offshoot of SOX in the USA due to the Andersen thing...less so the East Asian crisis.” – private sector 3

A couple of my interviewees also used to work for Andersen or had an Andersen connection. Ironically, the once-vaunted Andersen had a major role in introducing corporate governance into the country:

“I looked at the role of consultants that reformed the PSE, SEC. These included the ADB, Arthur Andersen – the latter was the Chief Consultant of the SEC and the PSE. Andersen talked about the need for good governance.” –academic

The corporate governance reforms in response to Enron were perceived by some interviewees as a study in prevention of corporate collapses:

“We welcome [corporate governance]. We can say that because of this [corporate governance] nothing similar to Enron will happen. Investors are better protected.” –private sector 3

“I’d assume corporate governance in the past few years have been strengthened probably because rules have changed and tightened. Investors and shareholders

are more familiar with the responsibilities of the company. Before, you didn't get dividends and that was ok. But now, the norm is to give back to shareholders. Lots of companies now distribute dividends. For a listed company, it's becoming the norm to issue dividends. There's also transparency - companies that are not being run well, you see lots of items in the newspaper on them. We want to institute governance mechanisms so you don't get these kinds of disputes. [All of this has been brought about by the Enron thing. The corporate governance has been strengthened but government have to learn how to implement it strictly on companies.] – private sector 4

In the post-Enron world of Philippine corporate governance, reforms are at the beginning and there is still a long journey ahead. The Philippines has yet to suffer a major blue chip corporate collapse ala Enron since the reforms:

“More or less the regulatory institutions have been effective. So far there is no Enron thing.” –bank

Similarly, uniformity in accounting standards remains a challenge. For Philippine companies who used to follow US GAAP, switching to IFRS - in light of the efficacy of American standards of reporting after Enron - continues to be a learning curve and a work in progress:

“In 2004 we shifted to the IAS from US GAAP” – public sector

“There is now a lot more you hear of complaints now on accounting standards brought about by SOX. Here, we used to adopt US GAAP, now it's based on IAS. This has been a big change.” –listed company (1)

“The accounting standards are not yet robust and we are waiting what will happen with the international accounting standards. The new standards are strict on disclosure. There are new accounting principles that are new to accountants which require a lot of disclosure. Previously, the financial statements are only 7 to 30 pages. Now they are 100 pages for financial statements which show more transparency. The new standards are based on the IFRS which the Philippines and most others subscribe to although the US has gone their own way with GAAP.” -accountant

For one company that has embraced corporate governance, an attitudinal change is occurring moving from a compliance-based approach to the more holistic understanding of why corporate governance must be implemented and recognised:

“Here, there is now a mindset of receptiveness. There is an appreciation that the changes are good. Everybody realises there’s a Basel II framework that must be complied with because it’s an international guideline and instituted after Enron. The corporate governance manual didn’t have the same negative reaction. The culture has changed. Especially the values have changed. There is now an emphasis on integrity, patience, hardworking, honesty.”-bank

However, a lot of convincing still remains on the positive effects of corporate governance:

“Our culture is poverty. We’re doing all this because of it. The perception is why do we need corporate governance? If corporate governance comes in, they argue, it is an additional expense. The benefits of corporate governance hasn’t been show or felt at all. They don’t feel it so why change it. I’m afraid that if they follow this it could be. Does an Enron have to happen first before changing the attitudes? -lobby group

Where the East Asian Crisis was largely systemic, the collapse of Enron was not. The destruction of Enron in a matter of months was monumental only now superseded by the collapses of companies and the general systemic failure of the investment banking industry in the 2008-2009.

Enron’s collapse was singular affected no other company in its industry. The problems were internal and the directors and managers of the company were largely to be blamed for its collapse in their failure to discharge their responsibilities properly. In the post-East Asian Crisis decade, the collapse of Enron was a tale of weak corporate governance, poor risk management in substance, and a board captured by its managers. The lessons of Enron are well-appreciated by the country’s private sector.

4.3.4 US Sarbanes-Oxley Act (2002)

Enron’s collapse precipitated the passing of the US Sarbanes-Oxley Act (SOX). This was the legislative response to the crisis that engulfed corporate America in 2001-2002. SOX

required more stringent oversight of companies and formalised the corporate governance responsibilities for managers of a corporation:

“Enron drove SOX and this filtered down to all stock exchanges. The issue of corporate governance issue was always there but Enron brought it more to the surface.” – private sector

“In the Enron aftermath they introduced SOX. The effect was reactive. Enron had the bad ingredients of corporate governance. The company was a photogenic case of corporate governance. They had all the elements.” – lobby group

A Philippine version of the US SOX was pending in 2007 and shared many elements of the American legislation. I had some discussion with several of my interviewees whether it was an appropriate form of legislation for a developing country given SOX was intended for American corporations and their prevailing business landscape. One interviewee mentioned how the country had always copied legislation from other countries, especially America as it is seen a country with best practice – or what is currently fashionable:

“What we have done is always copied [legislation] from foreign sources. We might have obscure original ones but we usually copy mostly from the USA or other countries. Sometimes it’s copied word for word. Whatever is the in-thing, we copy. If you copy it, we change it a little bit to conform to local practices. But the moment you pass it, it becomes a Filipino law, and is binding. Everybody follows it, and if you don’t there will be consequences.” –private sector 1

However, there was less enthusiasm for the full implementation of SOX in the Philippines given its highly prescriptive nature and the ensuing costs in complying with the law:

“It’s horses for courses. There is some presumption in the extreme and in the Western code of corporate governance, SOX is at the one end of the spectrum.”- private sector 2

“You don’t want to follow the path of SOX. SOX made it very expensive for companies. It made money for external auditors but the cost of compliance is prohibitive. In the last Congress, we almost had an exact copy of SOX. It didn’t

pass. We hope to resubmit it and we can come up with a better corporate governance reform law. Legislation is one of our reform areas.” –lobby group

For PLDT which lists on both the PSE and NYSE, compliance with SOX had some positive effects. The company’s corporate governance procedures improved though the compliance cost was increasing especially with regards to the internal disclosure requirement of section 404 of the legislation:

“The advantages are you comply with higher corporate governance standards. The disadvantages are the costs of compliance. In light of SOX, compliance requirements are very costly, principally due to the intensive, external auditors and time it consumes in regulatory compliance. Costs are very prohibitive. It entails lots of work to validate compliance requirements. Preparation for SOX compliance is because of s.404 with respect to the internal control processes. In s.404 all departments within the organisation have to revisit the processes with under the Financial Reporting Requirements.”-PLDT

For PLDT and other Philippine companies that are listed on the NYSE, SOX has had an effect on their procedures and internal risk processes. For an American legislation which sought to address American problems, it is a sign of the wide-reaching influence of American corporations that regulations seeking to cover them should reach extra-judicially.

4.3.5 The SEC and the Introduction of Corporate Governance

For the SEC, it had watched the corporate governance developments around the world before Enron’s collapse. As the corporate regulator, having the awareness to regulate is one thing; having the will, legitimacy and justification to regulate is another. Enron was the catalyst for major corporate governance reforms but there was momentum building up to make changes in corporate behaviour from the East Asian Crisis onwards. Society’s well-being is at stake when a large business collapses. Ensuring and having well-functioning businesses was at the core of this realisation:

“The awareness of corporate governance now is not yet at the level of which we could be. Given a scale of 1 to 5, if we could reach up to 4 in which we would in effect have greater acceptance of corporate governance. We have information

now [on making changes]. There is urgency, the emotion of urgency and that desire to be able to move it along.

“There was a time of awareness from 1997-1999. There was awareness in the capital market that confused a lot which created even more confusion and there was uncertainty on what they were being made aware of. The crisis showed there were governance issues in listed companies. There were severe governance issues in the real estate business on pre-selling and retailing items without too much disclosure.”-SEC

This awareness was echoed by another interviewee:

“Even prior to Enron, we were talking about shareholder value as the framework of good corporate governance and we were talking about that in that language and about the power of the institutional investor.” -academic

As other interviewees mentioned, while the East Asian Crisis was a monumental event in the institutional arrangements of other countries, the crisis made a blip on the radar but did not catalyse major reforms in the Philippines. From the SEC’s point of view, the crisis did not provoke a big enough concern to merit widespread reforms. The crisis was the lull before the storm:

“In the post-crisis environment, we were made aware of it. The finger was put on to it in effect. Like the undertow in the river, the water’s really calm but if you put your hand into the water, you can feel it, the pool at your feet even though one didn’t know what it was.”-SEC

The storm was the collapses that happened in Europe and America, and even in Australia with the collapse of HIH. Supposedly blue-chip, well-managed corporations were in fact poorly-governed. Corporate governance to the regulator means greater transparency and disclosure:

“Shortly after that, we heard [corporate governance] from the outside. There was a tsunami [of corporate collapses] that hit Europe (Parmalat etc). As a practicing lawyer mostly with British, Australians and Canadians, there was dialogue with others. We went through a difficult time trying to convince companies to make corporate governance changes.

“We were hearing it from the West, through the words corporate governance, transparency, disclosure – having a regime of disclosure. We would gauge the company’s disclosure. In the Philippines [the disclosure] might look solid but it is mostly run by the family or the director’s family. Under the regime of disclosure, we are able to find weaknesses in this company.

“This is what [corporate governance] means. In quick succession Enron and other collapses came and the whole scenario played out. All of a sudden there was a comparison of what was happening and trying to structure what was happening in place. When Enron came about, some went to the US SEC so we got an orientation about this difficult case study. There was also Parmalat but we looked at Enron closer due to similarity of things.”-SEC

Arguably, the lessons of Parmalat are probably more poignant given the business environment of Italy and the Philippines share similar elements in terms of having family owners of corporations. Parmalat’s owners, the Tanzi family also engaged in several related party transactions to ensure family control – an action not so dissimilar to those exercised by owning Filipino families to ensure control of corporations. Nevertheless, the collapse of Enron was seen to be as the exemplar given the ties of history, culture and language the Philippines had with the USA.

Enron and its legislative response, SOX, provided the major impetus for introducing corporate governance in the Philippines. This event, rather than the 1997 crisis gave the regulator the credibility, legitimacy and reason to introduce corporate governance in the country. A level of understanding was reached between the regulator and the corporations on the necessity of introducing corporate governance:

“All of that was blowing in the wind. Enron’s collapse had made it more focused and [we could concentrate on introducing corporate governance]. We would find modules, look at SOX and see if this is the way to do it. We are finding out other laws to make it simpler. We understand English - all our business schools’ classes are in English. All our corporate governance institutes speak English. It was not difficult for us to understand the importance of corporate governance. The business sector had reached a certain level, given time and effort to do this exciting thing and gave them room to be careful again. Many had corporate

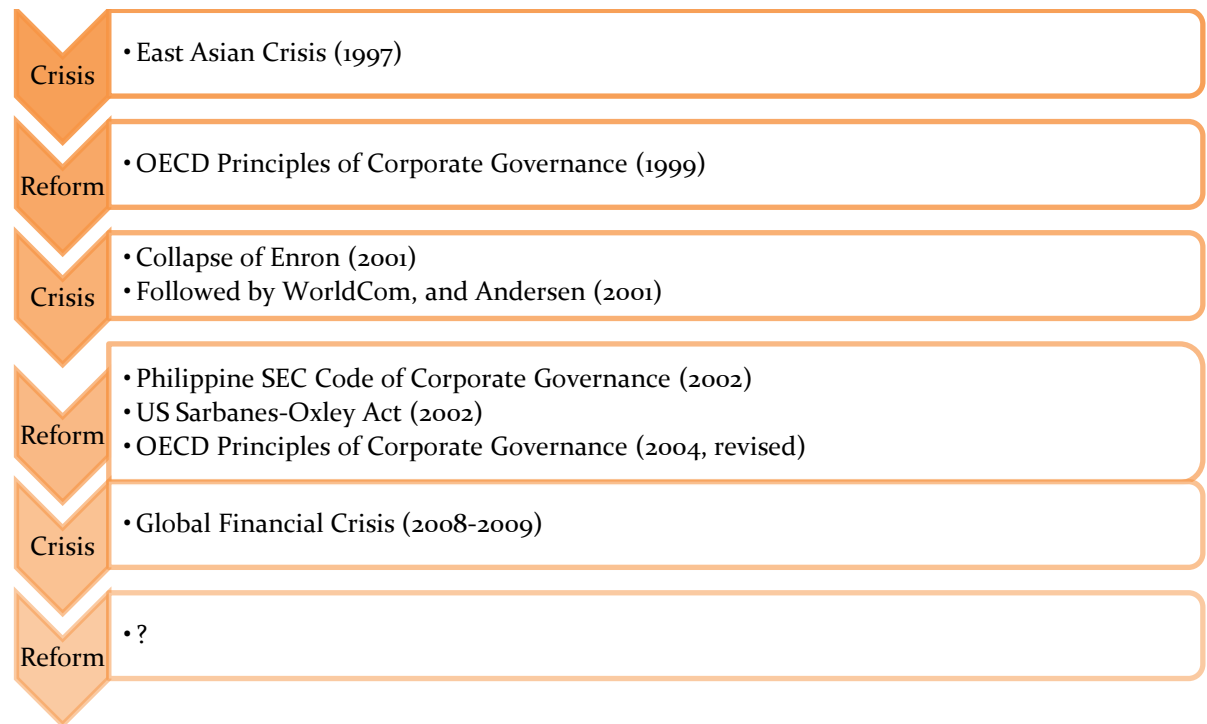
governance in place but didn't put it in place. This is how [corporate governance] jumpstarted and there is now regular transmission from gear to gear.”-SEC

Perhaps not so dissimilar from other corporate regulators, understanding why one must sit back and wait for a big enough collapse before regulating shows the nature of regulation. Awareness is one thing, regulation is another. The latter needs public support and legitimacy from wider society in order to be accepted. Regulators need cause to regulate: an action-reaction approach. Perceived unnecessary preventative behaviour by imposing regulation would bring calls of further administrative burdens. While the SEC showed they were aware of what was happening in corporate governance, how best to react to it needed a catalyst before corporate governance could be introduced.

4.3.6 Cycle of Crisis and Reform

A crisis provokes a regulatory response. The East Asian Crisis saw the OECD Principles as a response. The collapses of American companies in 2001 saw the main corporate governance reforms introduced into the country with the Philippine SEC Code of Corporate Governance in 2002. Later that year, SOX was passed in the US and the revised edition of the OECD Principles was published two years later in 2004. The GFC of 2008-2009 are yet to have a formal regulatory reform response in the Philippines at the time of writing. However as previous experience has shown, international developments have a profound impact on the corporate governance reform of the country. Following Clarke's thesis of the cyclical nature of crisis and reform (see Chapter 2), for this research a summary of this cycle can be seen in the next figure:

Figure 18: Cycle of Corporate Governance Crises and Reforms



This section provides overwhelming evidence to support my first hypothesis on how foreign principles formed the basis of local corporate governance principles. The next section displays the institutional isomorphic activities to force them on the local environment.

4.4 Introducing Corporate Governance Reforms and Institutional Theory

The previous section provided the background and context of the rationale behind corporate governance reforms. This section deals with how corporate governance reforms were implemented in the country through national (regulatory) institutions and private sector organisations. The main theoretical contributions of this chapter relate to the macroeconomic aspects of introducing corporate governance reform through the lens of institutional theory and specifically institutional isomorphism.

Concurring with the theoretical basis of institutional theory, the introduction of corporate governance reforms in the country was done through a mixture of coercive (especially from external institutions) and mimetic isomorphism. This section will look at both coercive and mimetic isomorphism to explain the ‘guiding hand’ that introduced corporate governance into the country. Coercive isomorphism provides support for the

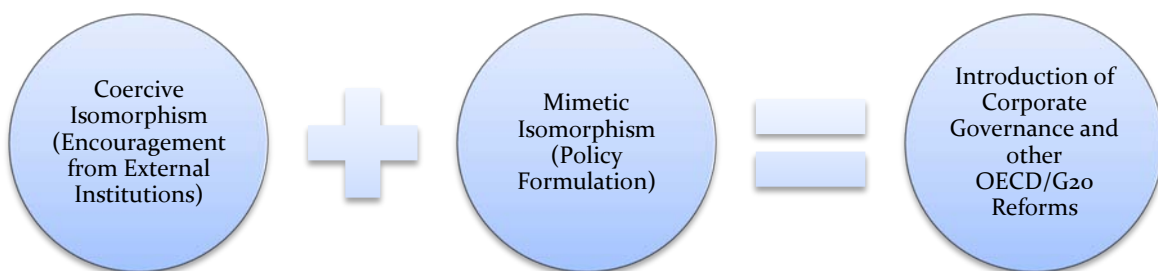
reforms motivated by external institutions, while mimetic isomorphism is present in policy formulation. Together they provide an explanation on how externally formulated corporate governance reforms were introduced into the country.

Similar to the previous section, this section heavily provides support for my first hypothesis in that it provides greater details on the introduction and operationalisation of these policies in the country with the explanation of institutional theory:

***H1:** Post-1997 corporate governance policies in the Philippines will exhibit similar ideas contained in Western principles of corporate governance*

The following figure graphically explains the combination of these institutional isomorphic elements to provide an explanation for the introduction of the reforms:

Figure 19: Institutional Isomorphism and Introduction of Corporate Governance Reforms



Coercive isomorphism deals with the encouragement by external institutions to introduce corporate governance while mimetic isomorphism deals with policy formulation to operationalise corporate governance reforms:

4.4.1 International Financial Institutions and Introducing Corporate Governance

Support for the introduction of corporate governance reforms was done at a very high level heavily influenced by International Financial Institutions (or IFIs). In the context of the Philippines, the institutional influences came from the OECD, World Bank and the ADB. From the highest level there was coercive isomorphism to bring the country in line

with the region. The World Bank's assessment on the introduction of OECD corporate governance throughout the world through their "Reports on the Observance of Standards and Codes" (ROSC) is the major influence in the standardisation of corporate governance in developing countries as the following passages indicate:

"The assessment of corporate governance practices in a country measures the legal and regulatory framework, as well as practices and compliance of listed firms against the OECD Principles of Corporate Governance. Since the OECD Principles of Corporate Governance were agreed in 1999, they have formed the basis for corporate governance initiatives in both OECD and non-OECD countries alike." (World Bank 2004a)

"The objectives of this program are to:

- Benchmark the country's corporate governance framework and company practices against the OECD Principles for Corporate Governance.
- Assist the country in developing and implementing a country action plan for improving institutional capacity with a view to strengthening the country's corporate governance framework.
- Raise awareness of good corporate governance practices among the country's public and private sector stakeholders." (World Bank 2004b)

Indeed, the push by the International Finance Corporation (IFC), the private sector arm of the World Bank, to implement the OECD form of corporate governance has rendered a template and tick-a-box approach in assessing participating developing countries as they are matched against the OECD standards of corporate governance. A country received points if they recognised an OECD corporate governance standard. The points ranged from 1 which represents *Not Observed*, 2 is *Materially Not Observed*, 3 is *Partially Observed*, 4 is *Largely Observed* and finally to 5 which represents *Observed*. (McGee 2009)

The following extract contains the World Bank's 2006 Summary of Observance by the Philippines of OECD Corporate Governance Principles. The tick-a-box assessment places the Philippines as partially observing most of the OECD Principles:

Figure 20: Extract of Summary of ROSC Observation in the Philippines (World Bank 2006:9)

Summary of Observance of OECD Corporate Governance Principles						
Principle	O	LO	PO	MO	NO	Comment
I. ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK						
IA Overall corporate governance framework			✓			• Improving corporate governance framework
IB Legal framework enforceable / transparent			✓			• Transparent legal framework, weak enforcement
IC Clear division of regulatory responsibilities			✓			• Clear division of responsibilities
ID Regulatory authority, integrity, resources			✓			• SEC budget inadequate
II. THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS						
IIA Basic shareholder rights		✓				• Basic rights provided and observed
IIB Rights to part. in fundamental decisions		✓				• Fundamental decisions decided with 88% majority
IIC Shareholders AGM rights			✓			• Notice period two weeks
IID Disproportionate control disclosure			✓			• Basic disclosure required
IIE Control arrangements allowed to function			✓			• Mandatory bid at 35%
IIF Exercise of ownership rights facilitated			✓			• No requirement for disclosure of material conflict of interest by institutions investors
IIG Shareholders allowed to consult each other		✓				• No obstacle to consultation
III. EQUITABLE TREATMENT OF SHAREHOLDERS						
IIIA All shareholders should be treated equally			✓			• Equitable treatment, redress possible
IIIB Prohibit insider trading			✓			• Insider trading regulated
IIIC Board / Mgrs. disclose interests			✓			• No requirement for disclosure of interest by directors
IV. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE						
IVA Legal rights of stakeholders respected		✓				• Strict enforcement of labor code
IVB Stakeholder redress			✓			• Stakeholders have access to legal process
IVC Performance-enhancing mechanisms			✓			• Employee stock option available
IVD Stakeholder disclosure			✓			• Stakeholders have access to public information
IVE "Whistleblower" protection				✓		• Limited whistleblower protection
IVF Creditor rights law and enforcement				✓		• Access to credit information weak
V. DISCLOSURE AND TRANSPARENCY						
VA Disclosure standards			✓			• Improving disclosure standards
VB Standards of accounting & audit		✓				• IFRS now required for listed companies
VC Independent audit annually			✓			• Improving audit quality
VD External auditors should be accountable			✓			• Civil liabilities available for auditors
VE Fair & timely dissemination			✓			• Selective disclosure prohibited
VF Research conflicts of interests			✓			• Rules in place, no sanctions imposed yet
VI. RESPONSIBILITIES OF THE BOARD						
VIA Acts with due diligence, care			✓			• Fiduciary duties codified in law
VIB Treat all shareholders fairly			✓			• Equal treatment required
VIC Apply high ethical standards			✓			• No all companies have code of ethics
VID The board should fulfill certain key functions			✓			• Code of good practices
VIE Exercise objective judgement			✓			• Directors' training improving
VIF Access to information		✓				• Boards have legal access to information

The ROSC assessment is supportive of the argument for convergence of corporate governance codes and the top-down manner of this imposition is set out in the following passages. There is no disguising the templated approach undertaken by the World Bank:

“The assessments:

- use a consistent methodology for assessing national corporate governance practices;

- provide benchmark indices by which countries can evaluate themselves and gauge progress in corporate governance reforms;
- strengthen the ownership of reform in the assessed countries by promoting productive interaction among issuers, investors, regulators and public decision makers;
- provide the basis for a policy dialogue which will result in policy recommendations.” (World Bank, 2004a)

“The World Bank uses a diagnostic tool – a Template - that it has developed to gather pertinent information for preparing the Corporate Governance ROSC.”
(World Bank 2004b)

Other ways to spread corporate governance are through discussion roundtables hosted by IFIs attended by high level representatives from the public sector. The 10th Asian Corporate Governance Roundtable hosted by the OECD was held in Manila in September 2009.(OECD 2009). The following comment from a public sector interviewee shows how these ideas are filtered through to the regulatory level:

“Last April I attend a roundtable discussion on the Asian experiences of corporate governance for GOCCs (hosted by the OECD). So the principles of the OECD on the public sector came up.” – public sector

These high level roundtables allow the transfer of information of the concept and idea of corporate governance amongst high-level officials.

4.4.2 The Report on Observation of Standards and Codes (ROSC) and Coercive Isomorphism

The coercive isomorphic element of ROSC and its importance in filtering corporate governance through the regulatory bodies was highlighted in one interview. My interviewee showed me an email from an international financial institution (IFI) representative when he was chair of a regulatory body.

The IFI representative specifically wanted to discuss particular issues regarding the progress of corporate governance reforms in the country. The email discusses the possibility of a second country assessment as the first corporate governance assessment resulted in a very poor reflection on the country. The tick-a-box element of the

methodology was looking for similar situations (especially institutional) that existed in a developed country and applying it to a developing country position. The following box contains excerpts from the email and the consultative tone suggests the second assessment would not be as coercive as the first (the results of this second assessment can be seen in Figure 26 in the previous section:

Text Box 2: Excerpts from an email by an IFI corporate governance policy representative (2004)

Dear X:

“We had discussed the possibility of updating the ROSC corporate governance assessment...because it is important to measure progress over time, especially in important markets like the Philippines.

“An update in the Philippines would not be a mechanical repeater of the first assessment. While it would measure progress over time, the policy would be broader – especially if well all work together.

“First, the OECD Principles themselves were revised [NB – the OECD Principles were updated in 2004 after initial publication in 1999]. The World Bank-OECD Regional Roundtables and the Corporate Governance ROSC Assessments reflecting the experience in developing countries and transition economies provided significant input to these revisions. One of the results is that the revised Principles now include a separate section on the supporting legal and regulatory framework which reflects the importance assigned to the institutional backdrop for an effective corporate governance framework.

“In parallel, we have updated and modified the methodology to reflect the changes of the [OECD] Principles as well as the lessons learned from conducting the assessments. *The new report format allows us to highlight key issues and focus on recommendations on how to implement and enforce corporate governance reforms* [own emphasis]. The country team has now expressed interest and I’m looking forward to meeting with them when in the Philippines.

“I would be grateful if you could point out to the council that the [previous] review was a “quick review” which would be an important input into a formal update but does not replace the need for one...if it is not asking too much, I would also be grateful if you could arrange for a meeting with the council when I’m in Manila.”

Such high-level approaches in introducing global reforms are common or are seen as the most effective way in reaching out to key local policymakers. For example, the following World Bank document on tackling corruption in the country cited the assistance of other country-donors and concerted action with regulators and local associations to improve corporate governance in the country:

“Helping to Improve Corporate Governance: The East Asian Crisis exposed shortcomings in regulation, supervision, corporate governance and ownership. The WB, along with several donors (ADB, USAID, AusAID), is supporting the government’s corporate governance action program which involves an integrated set of reforms to be implemented by the BSP, SEC, PSE, PICPA, and ICD.” (World Bank Office in Manila 2001: 2)

While the OECD notes the corporate governance principles are they themselves “non binding and do not aim at detailed prescriptions for national legislation” (2008:105), their influence due to their wide adoption by IFIs shows the coercive or ‘push’ element to introduce corporate governance in member countries.

4.4.3 Ramifications of the ROSC Assessment

The outcomes of the ROSC assessment have not been pleasant and they show the unintended consequences of institutional isomorphism. For developing countries such as the Philippines, the OECD standards have been operationalised by the World Bank through their ROSC assessment. Controversy over the results of the assessments has struck fear, humiliation and/or profound soul-searching by local institutions that were largely affected by the assessment. The country participated in the second assessment and the results profoundly affected the regulators (World Bank 2006).

Effective corporate governance reforms require taking into account the local environment’s situation and the ROSC remain controversial. For example, following the OECD Principles the ROSC assessment heavily emphasises the rights of shareholders. In developed countries where there is widely dispersed ownership and greater shareholder participation in the population through their own shareholdings or through pension funds, shareholder rights are emphasised heavily especially when the managers of the corporations are not themselves major owners. However, in countries such as the Philippines where a single person or family owns over 50% of a publicly listed corporation and stock market participation is still the preserve of a few, emphasis of shareholder rights over issues such as those relating to government (e.g. expropriation, institutional capacity) remain a testy point. As pointed out by one interviewee:

“A major influence would be the fact that a lot of Philippine companies are family-owned close corporations. These family-owners may have different levels

of appreciation of the relevance of corporate governance principles and practices to how they do business, i.e. as families. Regulators should consider this reality in formulating their implementation strategies.” – Manulife

What the ROSC assessment overlooks is the different roles government plays in developing countries in determining corporate governance development. Government can be regulator, shareholder, stakeholder, facilitator, underwriter or even, antagonist.

Thus, there are questions on the appropriateness of such a standardised approach taken by a highly influential body that also funds the country’s development programs. The political argument underlying this is the results from such assessments will form the basis for future World Bank aid programs for the country. The investment argument for these is that foreign investors will use the ROSC results to take a pick-and-choose approach in diversifying and determining their emerging market investment portfolio.

The political and organisational ramifications of a simple tick-a-box questionnaire from an IFI are enormous. Below is an extract from an SEC-wide email by the SEC Chair on how it viewed the ROSC assessment and trying to reassure its employees the limited impact of this external judgment:

“We may agree or disagree with the World Bank’s assessments – entirely, or in part. The degree of assent or dissent also varies from one to another. These only underscore the fact that an assessment, an evaluation, or an appraisal is inherently subjective. In other words, it is a judgment, based on certain standards, principles, criteria. In the case of a not-so-favourable assessment one can have a negative reaction. We do not agree with the judgment, so to speak, so we come up with rationalisations, explanations, finger pointing – why we did not fare so well.

“There is also a positive reaction to an assessment that is not so rosy. But I am not sure if this is more dominant than the negative one in the Philippines. I said positive because those who get an assessment like *Partially Observed* treat it as a wake-up call, a challenge to do better next time, to strive more. Not because they wanted a rating of *Observed* or *Largely Observed*. It is more of working harder because it accelerates the transition from principles to actual practice of good corporate governance.” – SEC Chair Barin (2006)

The ROSC externally assessed the regulators and pointed out the defects in their regulatory capacity. The less-than-positive results have alienated them. For the regulators themselves, the ROSC assessment compounds the perception of corporate governance as external tools developed without the input of local conditions. Decoupling the ROSC results from how regulators implement more suitable and credible corporate governance reforms locally will take some time to do.

4.4.4 Mimetic Isomorphism and Global Corporate Governance Convergence?

At the formulation and implementation level, regulators sought guidance from existing corporate governance policies. With the backing of the IFIs, the OECD Principles of Corporate Governance became the default template for the Philippine regulation of corporate governance, as with other developing countries in the region. The policy formulation of corporate governance in the country is mimetic isomorphism in action as the following regulator explains:

“We took the contents of our code of corporate governance from the OECD 1999 Principles of corporate governance template. We downloaded the materials and the template from the website. The SEC took the initiative and downloaded the principles. Why? In 2000, the SEC got reorganised. The SEC was busy (that’s why things didn’t happen immediately after the crisis), we were waiting for Senate approval for the new SEC code, regarding the governance principles, disclosures and accounting.” – SEC I

The other regulators followed suit and so with the introduction of corporate governance in the country, institutional isomorphism was present:

“The Insurance Commission circular was based on the SEC corporate governance of 2002. The BSP has no code of corporate governance but the BSP requires bank directors to attend corporate governance meetings and under the General Banking Act³³ of June 30th 2000, the directors must adhere to the ‘fit and proper rule’. Initially, it was difficult to implement this. They questioned the legal basis, even if it was not in the Corporation Code. There is a basic corporate code in the 1980s. Chairman Bautista, SEC took the position to include the ‘fit and proper

³³ General Banking Act of 2000 or Republic Act No.8791
<http://www.bsp.gov.ph/downloads/Regulations/gba.pdf> accessed 20 November 2009

rule' in the Manual and Code as the main criteria of independent directors." – SEC I

As several interviewees pointed out, external imposition of Western standards is not unheard of in the country therefore isomorphic tendencies are not unusual. In this sense some of these comments provide support towards the thesis of a global trend towards corporate governance convergence and harmonisation albeit with several disclaimers:

"Filipinos are culturally attuned to developments in Western business concepts. The Philippine regulators (SEC, PSE, Bangko Sentral), readily adopt business standards set by Anglo-American companies and impose those so that local companies can more easily access foreign capital." – BPH

"The [corporate governance] effort is global. It's a small community Pressures have risen. There are pressures to harmonise governance practice. So [in the private sector] there was agreement with the ICD founder, and Ausaid was heavily involved. There is a formulation for business conduct, greater transparency, and business behaviour. There was strong encouragement from the BSP, SEC. A very strong encouragement from regulatory authorities to establish codes of conduct for directors, independent directors, and regulated entities." – private sector 1

The notion of financial liberalisation as driving corporate governance, one interviewee pointed out the flows of investment from the investing country and their standards were having an impact:

"The crisis opened the eyes of the regulators in particular to own up to their ability of introducing a system for corporate governance. We are currently learning from each other. From the US we are learning from the lessons of Enron and WorldCom. For the moment the US drives us and they are big investors in the Philippines. The best practice [of corporate governance is] defined by the big funds in the US and certain rules are adopted or they are pressing us to adopt. The Fed's been hard to do the same on transparency, accountability. It's a race for everyone.

"In China it's the same. The US investment flows in to Asia are an important driver in terms of general [corporate governance] principles compared to a

dotcom crisis or Enron. Which one's influencing whom? The fund manager in the Philippines had to deal with an earlier debt crisis – not with Asia but with Latin America in the 1980s. The debt crisis happened in the Philippines and Latin America at the same time. This crisis only affected the Philippines and no other Asian economies were affected. As a result of that [crisis] there were a lot of regulations introduced to strengthen the system. [Today,] bank supervision goes hand-in-hand with corporate governance.”-private sector 2

This comments provide some – but not overwhelming - support for the globalisation of corporate governance and possible convergence of standards as being largely influenced by short-term investment flows and catalysed by crises in the financial sector. However, using a developed country standard and applying it to an emerging market where it was not initially meant for remains a challenge. Corporate governance in the Philippines shows the struggle between the imposition of external Western standards to the prevailing environment. In this sense, corporate governance is somewhat idiosyncratic and alien as it did not evolve from the bottom but rather imposed from the top. The following comment comes from a regulator who pointed out the practical realities developing countries face in introducing reforms largely formulated by developed countries:

“I attended an OECD Roundtable [for East Asian regulators] in Tokyo...there was talk on the IASB and governance. The Thai representative said, “we don't like corporate governance it's destroying our own companies.” We hope it doesn't end up unlike the IASB. It really is a pain. The US is changing SOX, moving around...[we can get] blindsided by these reforms.” – regulator

4.4.5 Other International Standards

Other edicts aside from the OECD Principles readily find an audience in the Philippines. In particular, the country has moved towards complying with the International Financial Reporting Standards (IFRS) from the International Accounting Standards Board (IASB) in terms of financial statement reporting (SEC 2009). Similar to the goals of Basel II for the banking industry, global convergence of accounting statements is a goal of the IASB:

“The goal of the IASC Foundation and the IASB is to develop, in the public interest, a single set of high quality global accounting standards.” (IASB 2009)

Previously, companies in the Philippines were using the US GAAP [Generally Accepted Accounting Principles] model of reporting but now most reporting has moved towards complying with IFRS:

“The Philippines has more IAS [International Accounting Standards] now, although it had an affinity with US GAAP.” – private sector 1

The BSP’s 2005 circular issued compliance by companies with Philippine Accounting Standards that have been modelled after the IFRS rather than US GAAP (BSP 2009). This transition from one form of reporting to another has had its challenges:

“People know they are the regulators, they’ll get the flack for not policing the market. This is true for the SEC. They must have their financial orders in on time, and they are now [moving towards] IAS.” – private sector 2

One sector affected by the change in reporting, the college assurance plans (CAP) industry, saw a detrimental effect on the pricing of their products (see Chapter 5 on the SEC):

“[The issues in the college assurance plans] were due to the change in the financial statements [we were] moving towards the IAS – a direct product of that [turned] a profit into a loss” – academic

Thus, whether it is entirely appropriate or fully implementable for the country to incorporate these global standards is an ongoing matter as a regulator points out:

“The Philippine Accounting Standards is a relative copy of the International Accounting Standards. [However] we can’t fully abide [to the IAS]. We are as global as can be. There are penalties. [The private sector] is asking for leeway and for some difference. We move the standards in order to fit but there are idiosyncrasies to fully implement them here. So there is a disclosure in the footnote, it’s there. There is monitoring if there are any issues. However, [in terms of corporate governance, some firms] are suspended and penalised if they don’t have independent directors.” – SEC

The imposition of external ‘global’ standards overlooks some of the particularistic local issues present in the business environment of the country. The harmonisation of global financial standards will remain problematic and a source of tension as policy level issues

dictated externally will need to be modified appropriately to gain legitimacy and to suit local conditions.

4.4.6 Summary of Corporate Governance's Introduction

The following figure summarises how corporate governance diffused from the germination of an external idea and mainly formulated with developed countries in mind to being introduced in the local Philippine environment:

Figure 21: How corporate governance reforms were introduced into the Philippines



Step 1 shows the importance of the external influence of IFIs.

Step 2 shows the necessary high level interaction between the IFI and local influentials to ensure the transfer of knowledge, and later on, acceptance of this reform:

“Quote me on the Capital Market Development Council (CMDC) on how corporate governance started. As Chairman of the CMDC I appointed Jess Estanislao as Chair of the Corporate Governance Taskforce in 2000. That’s how [corporate governance in the country] began.” – Josue Camba, Chair of Basic Energy

Step 3 is the formal mechanism of setting up an organisation that will look at how it would operationalise the reforms into the local environment. The backing of the political branch of the country, the President's approval executive order no less, is necessary for this organisation and its operations to receive widespread legitimacy and esteem. Members of this organisation would reflect various interest groups but more importantly they are the leaders who will carry out the reform.

The next section looks in detail the above Steps 2 and 3 with the establishment of the Institute of Corporate Directors under the aegis of Jesus Estanislao to ensure the reforms were localised to gain wider legitimacy in the country.

Step 4 reflects how those who would be enacting the reforms need to learn and know what type of reforms they are enacting. If there is internal opposition to such reforms, formal directives such as the comment below shows how regulators overcome their objectives:

“There's a new executive order on corporate governance which allows the Department of Finance to supervise so government corporations can set up their [corporate governance].” - public sector

Step 5 is the coalface interaction of reform being implemented by the regulator to the regulated. As one industry group explained:

“The BSP has had a series of circulars which strengthened corporate governance practices in the banking industry; also an insurance circular for the insurance industry.” - IIA

Chapter 5 on Regulators looks more closely at this. For existing professional associations, having their input was an important step in spreading the idea of the reform to their members:

“The Institute for Internal Auditors (IIA) became instrumental in drafting the SEC Corporate Governance Code. Some aspects of the draft were already done and they were asked for comments or input on it. The IIA is one of the key players in drafting the code. The IIA was called in by the SEC Chairman to look at the circular draft. Some principles of the draft came from the OECD. The SEC was taking best practices from all over the place (Malaysia, Singapore) and other

environments and was not tailored after the USA SOX as SOX came after the circular II.” - IIA

Finally Step 6 is the application and operationalisation of the reforms by the private sector within their organisations themselves. Chapter 6 looks extensively at the impact of corporate governance reforms from the perspective of the private sector, while Chapter 8 looks at the introduction of corporate governance in government owned corporations.

The OECD (corporate governance) reforms or G-20 (banking) reforms may have the very best of good intentions but in a developing country context where transparency is scarce and the political environment can be quite unstable, the bureaucracy and regulatory arms have tended to sit uneasily in the middle. Thus, the instability of a nation-state is not taken into account when principles or standards are formulated and unilaterally imposed especially in Steps 5 and 6.

Where the reforms may contradict the political conditions and sensibilities, then they will not be implemented for they will not receive support. The imprimatur and political backing is important for these reforms to have an effect: legitimacy from the top is required, while wider acceptance from those affected by the reforms is fundamental.

The pre-existing arrangements- especially the institutional and cultural -do provide obstacles for the effective implementation of these principles. While they work in theory, in practice they need to be modified to take into account the heavily politicised nature of policy making in the country.

The next section looks at how corporate governance reforms were and are being conceptually adapted to better suit local conditions and address the problems mentioned in this section.

4.4.7 Locally Adapting Corporate Governance Reforms

While the previous section dealt with the tensions and the institutional isomorphic tendencies of corporate governance reforms – fine in theory, but what about in practice - motivators for the introduction of corporate governance or the operationalisation of corporate governance was and remains a challenge. Adapting principles largely suited for Western countries to developing countries is a work-in-progress. Thus, this section relates back to the both hypothesis 1 and 2 of my research where the first hypothesis tests

the form of corporate governance undertaken, and the second tests the substance of corporate governance reforms:

***H1:** Post-1997 corporate governance policies in the Philippines will exhibit similar ideas contained in Western principles of corporate governance*

***H2:** Post-1997 corporate governance practices in the Philippines institutions and firms will not diverge from indigenous customs.*

Where in Anglo-American countries, one consideration of corporate governance looks at ensuring destruction of shareholder value is mitigated, in the Philippines, corporate governance is seen as improving the business environment by reaching out to the owners of the company and improving standards of behaviour. Conceptually adapting what corporate governance means for the country is an important part of operationalising and supporting the reforms. As a largely Western concept, corporate governance must be made suitable and adapted for the local conditions to gain legitimacy, support and substance:

“Corporate governance must be operationalised at the corporation level and with the intention to do so. It is growing now. Companies with significant shareholders used to making decisions on their own also have issues of control. Governance brings but also demands.” – ICD

According to one company, corporate governance principles will be adapted as it suits the Philippines. In this regard, an emphasis on the principle-based rather than the rule-based perspective of corporate governance will find more support amongst locals.

“At the end of the day, corporate governance will grow in the region but in terms of the approach, Philippine corporations will take a different approach to the ones compared in the USA, UK. For those companies, it will be acceptable for them to have rules than principles based. Here, the emphasis will be on the latter.” – PLDT

One interviewee pointed out there were three main constraints to the full suitability of OECD corporate governance principles in the country with the highly concentrated ownership structure in a single shareholder or family the major difference between Philippine-style and Western-style forms of corporate governance:

“There are three constraints to corporate governance in the country: family

ownership is a major factor, economic distribution is another and the level of debt in your financial portfolio can also affect corporate governance as your creditors can influence your decision making. To address the constraints, we begin on values. There are families that subscribe to higher principles of corporate governance and ethics. You can begin by making the corporate governance model suitable to these higher goals. For outside principles to succeed, there must be a basic model that can be adopted to suit the local conditions here so other families can follow suit.” – business advocacy group

The importance of the family’s attitude and values towards corporate governance is reflected in the corporation. As the interviewee above pointed out, some families support corporate governance, some don’t. The following comment is one case of the ambivalent attitude towards adoption of full Western-style corporate governance:

“To me corporate governance is tied up with macroeconomic development and with government. It’s required practice. If you take the standards in developed countries, put it here it’s going to be problematic. We should evaluate Philippine corporate governance under Philippine culture. For example, you can’t have the same standards such as human rights here as in the West. What they think is human rights here, they then get problems. Adoption of Western principles here has to be tempered.” –private sector 1

For corporate governance reforms to have an enduring legacy, they will be substantively affected by how they address particular problems in the Philippines. The next section discusses some of these challenges.

4.4.8 Corporate Governance Challenges

The country’s past experience of crony capitalism showed a politically well-connected few were rewarded as a consequence of their connections and had a major advantage against others who did not. Corporate governance complements the concept of private sector development and calls for a level playing field in the country:

“There is an unfair competitive advantage for big players. 45 groups control 60% of the market capitalisation. That’s 45 family groups. In Indonesia it’s 16 family groups that control 69% of the market.” – corporate governance advocate

“[To improve the economy here], there are ideas that particular projects could be accelerated, a level playing field is present and government policies are transparent. This would allow a certain preparedness to compete. If there is too much regulation along the way, that will make costs of doing business high.” - private sector 2

“When you have heavily protected industries in areas of infrastructure, there are incentives in these industries to engage in regulatory capture. When you have well-regulated - but less protected - industries that create a more level playing field. The financial markets are wanting that. That’s short-term. In the long term, to improve the economy here, you need to change the constitution and allow foreign competition.” – private sector 3

Ensuring private sector participants behave in an ethical manner in a country riddled with corruption is no easy task. Straddling the line between behaviour that is corrupting and one that could ultimately corrupt is an unpleasant way to do business. To some interviewees corporate governance is part of the way in improving the private sector of the country and having a business environment conducive to investment. In this sense, corporate governance is a long-term process for businesses that is not completed overnight:

“It’s a start. I don’t think we as a whole are nowhere near where we want to be. It’s a good start. My concern is that the Western style will not work in Asia. For companies like us, it’s no problem for us for sure. But I’m not sure if it will work for family-owned corporations. The Asian Institute of Management (AIM) recognised that managing a family corporation is a discipline itself. We can’t use the Western model of management. The concentration of ownership here is reflected in family-owned corporations.” – private sector 4

In a country where the culture is family oriented, too much familiarity creates a sense of self-centredness or reflective of one where the state is captured by a few, and a feeling of hopelessness of those who cannot influence the state. Thus, in promoting governance at the public and private sector levels, a sense of nationalism and patriotism is invoked to love the country beyond one’s self: “*Mahal ko ang Pilipinas*” [I love the Philippines] as the common catchcry. (Estopace 2007)

For private sector participants who have to implement the operational aspects of corporate governance, they share the same sentiments as other private sector participants in the developed world – seeing corporate governance as compliance. Some interviewees spoke of their weariness on the compliance-based approach, while others were supportive of why they were doing it and to ensure corporate behaviour is done in an ethical manner:

“There are elements of corporate governance of telling people what “it” is. People don’t know what it is yet. Corporate governance is not simply attending about some [training], it’s not just compliance with SEC rules; it’s a function of the director to the public.” – private sector 5

While the compliance-based approach towards corporate governance helps in heightening the awareness for companies to its duties and obligations to a wider audience, it is the higher-level understanding of what the reasons are behind their introduction that will have the profound impact. As the rest of the world has introduced codes or principles of corporate governance, other interviewees feel that by practising corporate governance, the country has joined the international community:

“We’re hoping to be in on this as part of the international standards for corporate governance.” - regulator

Lastly, one interviewee was more circumspect about the effectiveness of corporate governance in the country and from his observations how companies try to straddle the internal and external pressures. He sees a divergence between groups of companies that implement and observe corporate governance in substance, and the other groups that don’t:

“[The future of corporate governance] will still be dichotomies. There will be segregated corporate governance with one form of corporate governance for the very big listed professional corporations and another form of corporate governance for the majority who are still family-based and non-professionalised. The former will also be more involved with an expanded notion of stakeholders, paying more attention to the community and employees with some of the corporations especially the bigger ones who are more involved into CSR.”- academic

Grudging acceptance of adopting externally imposed reforms have been the outcome of the introduction of these largely Western based corporate governance reforms. While not wholly embraced, increasing transparency, accountability and disclosure are worthwhile ideas that have resonated in the aftermath of financial crises.

The next section looks at the importance of having a figurehead in the country to spearhead the reforms in order for the reforms to take a more local flavour and gain wider legitimacy.

4.5 Dr. Jesus Estanislao and the Institute of Corporate Directors

Throughout my data collection journey, the Institute of Corporate Directors (ICD) came up often as the principal answer when asked how corporate governance was introduced into the country. Amongst interviewees, the organisation is widely known as having spearheaded corporate governance reforms in the country. The ICD continues to be associated with Dr. Jesus Estanislao as the main corporate governance champion and major advocate in the country, ably helped by the very active JJ Moreno.

The establishment of the ICD with Dr. Estanislao as figurehead has made the organisation synonymous with Philippine corporate governance. His role and organisation fills in Steps 2 & 3 in Figure 21 on How Corporate Governance Reforms were Introduced into the Country.

ICD's establishment was assisted by Australia through its development assistance arm of AusAid. Several of the ICD fellows were funded by AusAid to undertake director training at the Australian Institute of Company Directors (AICD). Other countries in the region (such as Thailand) benefited from this support from Australia in formalising a company directors' program locally. In the ICD offices, I was shown how the technical equipment all had AusAid stickers plastered "a gift from Australia" –an indication of Australia' soft diplomacy approach in the country and wider engagement with the region.

The ICD is making progressive inroads into the wider adoption of the professionalisation of directors and management of the enterprise:

"Corporate governance has improved since 1997 in certain companies at least. The large companies here are aware of corporate governance. Management, directors believe there is a lot of value in the governance thing. The culture or

practice is still being sorted out on what is the best way. They see it more and more.”- ICD

Many interviewees regarded Dr. Jesus Estanislao as the main instigator of corporate governance in the country. He was pivotal in gaining legitimacy and wider embrace of corporate governance. Estanislao is a highly-regarded Filipino both nationally and internationally. The office of the ICD pays tribute to the dynamism and influence of Estanislao. Photos of Estanislao with world leaders and influentials dot the walls of the office. He is an institutional reformer and builder. An account of the founding of the ICD and its founder follows:

“There was a tremendous amount of goodwill towards the ICD Chairman Dr. Estanislao. He set up two institutes:

1. Institute of Solidarity in Asia (ISA) – for public governance issues
2. ICD – for corporate governance issues

The ICD and ISA were established largely because of him. Dr. Estanislao is well-known around the region in community-building and is a consultant to the previous and current Pope. Dr. Estanislao founded the University of East Asia and the Pacific, was the former Secretary of the DPPI, and was a founding member of the ADB Institute.

“When ICD was organised, it was implicitly done to serve a principal (Estanislao). Before I came to the ICD, the organisation was about supporting the principal and his activities and not much about governance. In effect, it was a personal office to support the advocacy of the chairman. The plan to implement corporate governance projects and to develop professional directors came in 2002. Then a business plan was developed to promote corporate governance.” – JJ Moreno

Estanislao’s past history and achievements still lingers on in other organisations he reformed (one of these organisations, the Development Bank of the Philippines pays tribute to him; see Chapter 8 Government Financial Institutions). In the Philippines, his past record and achievements in both government and the private sectors have given him the legitimacy to pursue corporate governance reforms and apply them in the country (see Chapter 5 The Regulators: *Bangko Sentral ng Pilipinas*). Estanislao’s

leadership is held in high esteem. Interviewees spoke of his role as pivotal in championing corporate governance in the country:

“Estanislao – he was the former Secretary of Finance. *Malakas siya*. [He’s strong]. Corporate governance would be adapted [with him at the helm].” –private sector 1

“Corporate governance was started by Jess Estanislao after he was approached by the Australian Government. He was funded by the ADB. Subsequently, AusAid funded people to go to the AICD directors’ course. More [of the] ADB [funds] should [go into funding for these courses]. The champion here is Estanislao.” – private sector 2

“Estanislao is active in the region promoting corporate governance.” – BSP

Estanislao as corporate governance champion in the country and the region was recognised by the International Corporate Governance Network (ICGN) whose membership is largely comprised of institutional investors from the developed world. Estanislao was awarded with Robert ‘Bob’ AG Monks, a corporate governance expert, in 2002 recognising his achievement in introducing and raising standards of corporate governance in the country. While the East Asian Crisis was a motivator for introducing corporate governance, having Estanislao as the local figurehead for this reform was pivotal. Estanislao’s leadership and vision allowed corporate governance to gain currency in the country. The idea that corporations which are well-run and well-governed contribute best to society’s wellbeing could not hope for a better champion than Estanislao. As one mentioned:

“The East Asian Crisis did not have any impact on corporate governance. Corporate governance came into the picture not because of the crisis but because of a pioneering man called Dr. Jesus Estanislao who established the ICD. He was a director of MetroBank. He initiated corporate governance and he conducted a seminar on corporate governance for all directors of the MetroBank group, affiliated companies, insurance companies, savings and investment banks. All MetroBank directors attended this corporate governance seminar in 2002.” – MetroBank

The goodwill towards Estanislao and his past experience in government meant both he

and the ICD had political and regulatory support for its establishment and existence even though the ICD is not a public sector or government body:

“The BSP and the SEC are effective corporate governance institutions. They have been a good system for the reform movement. The ICD won’t be where it is today without the mandate from the BSP and SEC. We have 105 fellows, 1200 directors at the ICD attending through our one or two-day seminar. The ICD wouldn’t have gotten these numbers if not through the support from the regulators.” – business advocate

Similarly, the ICD has also received support from other private sector bodies such as the Institute for Internal Auditors (IIA):

“The IIA has actively participated in the ICD with an advocacy role with them. There is a mutual active participation between both organisations. For example, the ICD awards outstanding internal auditors for the last 3 years. Estanislao or JJ are very much active in judging. There are 1,000 members of the IIA.”-IIA

The trust and legitimacy ICD has gained in such a short time has made it the foremost pioneer and advocate of corporate governance in the country:

“We capture the issues in Philippine boards and provide contextual value. We deal with real issues such as and help corporations on topics such as:

- * independent directors
- * presence of significant shareholder board (what they’d do, e.g. expropriate and other certain issue); and
- * certain issues boards face when dealing with government” - ICD

The ICD provides a valuable service sorely felt in a country where family-owned businesses and a family-oriented culture dominate. The idea of professionalising the management to manage the ‘family business’ is still yet to be the norm. The following comment from a business family member on how attending an ICD training in the Philippines is a family event shows how director training has to be adapted to suit the culture in the country:

“I took the family to a one-day orientation - that is, the 10 family members involved in the business. Some found some of the aspects boring. There were

several generally good speakers with practical experience.”-business family member

This is the environment the ICD operates in and the ICD has adapted its courses to suit the sensibilities of the director community who circulate in a small social circle. The familial element in the private sector of the country means the ICD refreshingly provides impartiality and a third-party’s objectivity.

The primary stakeholders of the ICD place a great deal on the advice of the institute as providing a beacon for greater private sector development in the country. Not only is it an advocate for professional director training, it is also taking on other roles for private sector issues; namely to fill in for elements of institutional/organisational capacity still missing in the country:

“For the ICD, our major shareholders are the corporations and trying to get them to do the right thing. The other stakeholders are the community, the regulators, the media. We are actively involving the Institute of Internal Auditors – we call them the reputational agents, the lawyers. They are part of the government system with the corporate secretaries. We helped them set up an Institute of Corporate Secretaries. Others have asked us to set up a Shareholders’ Association.” – ICD

Other services provided by the ICD include board specific assessment on their performance and evaluation:

“We also provide Board Advisory Services, board retreats and board evaluation. Although we’d have open seminars, there are now specific intervention programs for specific corporations.” -ICD

For a country that still requires the establishment of major corporate governance institutions common in developed countries, the ICD is seen as providing the capacity to lead and expectations are high.

4.5.1 ICD Scorecards

As a way to measure the practice of corporate governance in the private sector, the ICD introduced and developed scorecards in corporate governance. These scorecards are a

benchmarking exercise that charts how corporate governance is proliferating in the corporations:

“[For us] 2002-2004 was marked by informing companies about corporate governance through training. After 2004 we wanted to know and find out where we are now, with and what type of governance that now exists in East Asia. We looked at the Thai corporate governance scorecards and we decided to bring them here to find what governance now exists here in form. To inform the companies about the scorecards we issued technical papers to state why we were doing it.

“After two years of running the scorecards we are trying to develop the second generation of corporate governance scorecards building on what colleagues have developed. We looked at findings from the World Bank and other IFIs. We’d like to be the incubator of our corporate governance scorecards. With the corporate governance scorecards we present our scores and our ratings on each corporation’s corporate governance.

“The first few years of the scorecard exercise was to increase the awareness and in measuring the impact of corporate governance. Now, the theme of the conference dinner on May 30th is that we have to promote corporate governance in one company and one corporation at a time.”-ICD

As the scorecards are also a ranking exercise, it brings out the natural competitive streak to strive to be recognised as a company that practices corporate governance best:

“There are five Ayala companies in the top 10 list of the corporate governance scorecard: Ayala Land, Ayala Corporation, Manila Water, BPI, Globe Telecom. China Bank did well on the scorecard so did Aboitiz-owned Union Bank: well known for their corporate governance practice.” – ICD

However, this also means that for those whose governance practices are far from desirable, the bottom rankings are not a pleasant place to be recognised. This is not an easy thing for the ICD to publish given Philippine society values saving face. Public humiliation is best avoided:

“There are 128 corporations representing 98% of the PSE. It’s not a pleasant

exercise to do to inform them, according to our rating, we have ranked you number 128 out of 128 companies. We give them feedback. The top 10 are publicly available but the rest are not publicly available except for the company concerned.” - ICD

Nevertheless, the ICD scorecards are a useful bottom-up exercise in monitoring the expansion of corporate governance in the country’s corporations:

“We have received recent score feedback and it’s about time to enhance the corporate governance scorecard system. In the third year of the scorecard, we hope to develop and share this with the rest of the region. Corporate governance improvements have happened in the corporations for the past two years.” -ICD

Unlike other jurisdictions such as Australia and other Anglo-American countries where reporting on a board’s evaluation and performance is an annual reportorial requirement, this is an optional element in the Philippines. Yet, the ICD does aim for best practice and as can be seen throughout this thesis there is a high level awareness of corporate governance developments around the world.

4.5.2 ICD and the Public Sector

However, corporate governance cannot be isolated from the other element that complements private sector development – that of public governance. Not surprisingly the public sector’s institutional weaknesses were also a concern in the ICD:

“The public governance in the Philippines is not the best in the world” - ICD

The ICD has also branched out into providing some of the services it provides the private sector to the public sector and state-owned enterprises (SOEs) of the country:

“The Insurance Commission now requires directors of insurance company boards to go on training with the ICD. This is similar with the Energy Commission. The Office of the Philippine President also requires directors of SOEs to go through the corporate governance training program.”-ICD

Furthermore, the problem of enforcement by government is a story that resonates throughout the Philippine political system and remains a particular challenge. The ICD

is interested in seeing more active enforcement by regulators though is cautious about the capacity of regulators to enforce corporate governance rules and mandates:

“Corporate governance has improved since 1997 in certain companies at least. The large companies here are aware of corporate governance. Management, directors believe there is a lot of value in the governance thing. The general, not many are sorting out. Not value. The culture or practice is still being sorted out on what is the best. They see more and more. They see slowly now from a business standpoint but each company proceeds at base. Regulators issued regulations and mandate what they have done. We have enough to go on. The challenge is enforcement. Whenever these policies are imposed, it is fairly hard for enforcement. It is not a question of whether they want to force. It’s the capacity to enforce. Issues need to be strengthened.” - ICD

The ICD is widely credited for formalising corporate governance in the provision of training and professionalisation of directors. The organisation is at the coalface of monitoring corporate governance progress in both public and private sector spheres.

4.5.3 ICD and the Future of Philippine Corporate Governance

The ICD under the aegis of its founder, Dr Jesus Estanislao, was and continues to be instrumental in introducing, formalising and cementing the operational aspects of corporate governance into the country.

The ICD currently sees a core influential group of corporations embracing corporate governance and applying it in their organisations though an expansion of this group would be welcomed. The organisation is also interested in seeing more effort in developing data for corporate governance. One of its fellows suggested he would like to see more stringent requirements in directorships as multiple directorships in the two-digits are common.

The future looks bright for the ICD and in the long term, the organisation hopes that major corporate governance developments would have taken place. Under the stewardship of Estanislao, the ICD and Philippine corporate governance are inextricably linked.

4.6 Closing Remarks

The business and corporate governance environment in the Philippines is being shaped, and will be shaped, by various politico-economic conditions. Corporate governance is a work in progress with initial reforms having met some resistance and requiring adjustment for them to be adapted and made suitable for local conditions.

This chapter supports on one level the coercive form of reforms, especially by means of high level approaches but the substance of these reforms are questionable. Attempts to insinuate such reforms take a long period of time to ensure it receives support from all stakeholders. The culture of consensus and conflict avoidance in the Philippines permeates through society from the top to the bottom.

Are corporate governance reforms the means or the ends? For one regulator at least, the failure to implement reforms saw her dismissal from her office. In trying to strengthen the industry, her position was weakened (see Chapter 5 Insurance Commission). This is another unintended consequence of coercive isomorphism. Failure to receive wide support or consensus makes a reform lose legitimacy and the role of the implementer – in this case a regulator - untenable.

These are the tensions and limits of externally imposed reforms. In response to the perceived rigidity of inorganic reforms, the unintended consequence is subsequent resistance. While the basis of the idea is there, the implementation is the challenge.

Nevertheless, the reforms have now been implemented in the country and the impact of the reforms is being felt:

“Corporate governance is a fairly recent development in the Philippines and is still evolving. It is worthy of note, though, that there is a much more heightened awareness on corporate governance now than before, and this awareness still continues to grow. It may also be noted that improved corporate governance regulations and practices have helped companies do business better.” – Manulife

The spirit of what corporate governance is suppose to achieve has now embedded itself in the country with greater awareness that well-governed companies do make a difference to a country's present wealth and economic future.

It is in the details of what constitutes transparency in an opaque environment, accountability in a private sector dominated by families, and disclosure in a volatile political environment that will contribute to a more functional economy and society. If the ultimate aim of corporate governance reforms is to contribute to a better business environment then the path has been paved for future tranches of these reforms to continue.

CHAPTER 5: THE REGULATORS

This chapter looks at the corporate governance regulators of the country and the impact of corporate governance reforms on these institutions. Regulators are important stakeholders in the corporate governance environment of a country. Why strong regulators matter in a country like the Philippines and issues faced by the corporate governance regulators – and the regulated – are discussed.

This chapter begins by discussing the importance of strong regulatory institutions. Common themes faced by all regulators in areas of regulatory enforcement, harmonisation, coordination, resources and dialogue with the regulated and complementary governance reforms in the public sector are discussed. This background provides the context of the corporate governance regulatory environment of the Philippines.

The bulk of this chapter devotes a section each on the regulators and their experience in implementing corporate governance reforms in their industry or sector. There are four main corporate governance regulators in the country. They are:

1. Bangko Sentral ng Pilipinas (BSP) or Central Bank of the Philippines. The BSP is the banking industry regulator
2. Securities and Exchange Commission (SEC). The SEC is the corporations and main private sector regulator
3. Philippine Stock Exchange (PSE). The PSE is the capital market regulator; and
4. Insurance Commission (IC). The IC is the insurance industry regulator.

The three government regulators are the BSP, SEC and IC. The PSE, similar to other countries around the world, have demutualised and is the non-government regulator. This chapter looks at specific corporate governance issues and problems facing each regulator and the industry it regulates.

5.1 The Importance of Strong Regulatory Institutions and Enforcement

This section provides evidence to support both hypotheses 1 and 2 of my research:

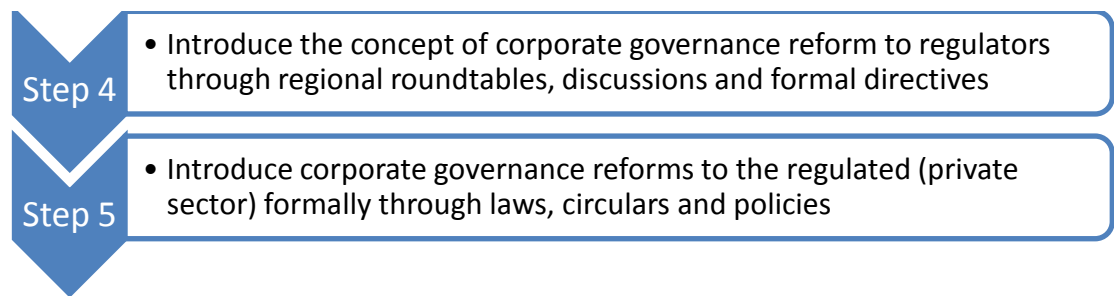
H1: Post-1997 corporate governance policies in the Philippines will exhibit similar ideas contained in Western principles of corporate governance.

H2: Post-1997 corporate governance practices in the Philippines institutions and firms will not diverge from indigenous customs.

where the formulation of reform is influenced externally, but application of corporate governance regulation is shaped by the circumstances and events of the regulatory environment. Sections in this chapter provide evidence to support both hypotheses and show the limitation of the underlying theoretical underpinnings of institutional theory.

Specifically, this section looks at the importance of institutional capability and enforcement of reforms by regulators and addresses Steps 4 and 5 from Figure 27 in the Chapter 4 on how corporate governance reforms were introduced into the country:

Figure 22: Introducing Corporate Governance Reforms into the Philippines - Steps 4 and 5



A reform formalised in a law or circular is ineffective if it is not enforced. As the previous chapter related, the Philippines has used standards developed for OECD countries for its corporate governance reforms. However, there is a widely held perception that the country has weak regulators and existing laws are not enforced:

“We have good regulations but the rule of law is not happening here. [The people who break laws] are not held accountable.” – private sector 1

“They have to be more pro-active in monitoring corporate governance compliance.” –private sector 2

A factor pointed out by another interviewee was ensuring regulators have sufficient knowledge on what they are suppose to be regulating as this would help them in their enforcement capacity:

“[You need to put] more people in government who are more aware and

appreciate corporate governance. The competitiveness ratings of a global survey initiative looked at the corporate governance criteria whether the companies were competitive or not. If the regulatory authorities don't know the value of corporate governance how can they regulate corporations to a competitive level?" – private sector 3

The problems of enforcement are a conundrum faced by many developing countries; the regulations may be modelled after the world's best but the issue of enforcement is far more pressing. If laws are not enforced, then the laws themselves become ineffective:

"I do feel many regulations are not being enforced. Insider trading is illegal here but much of it doing. [The regulation is in the] books but not enforced. [The] big guys get away while the little guys get caught even with the right regulation." – academic

The following interviewee gives a specific example on the problem with lack of monitoring and enforcement:

"We have just done the first step on corporate governance. We shall see. The enforcement of the [corporate governance] circular is not much felt. Monitoring compliance is not done very much. The SEC does not have much people monitoring compliance. Monitoring is on a self-assessment basis, and there is no follow-up. We have done the first step, so we're waiting for the next. There is no evidence yet of the circular being reinforced. If the monitoring is in place – only God knows! There were plans for SEC to partner with ICD on monitoring. With the BSP – there is not much in monitoring. There are better structural procedures in place than the SEC as the BSP has examiners and they can at least enforce compliance with the code unlike the SEC. With the SEC Self-Assessment, the companies were complying in paper but we're not so sure if they were complying in practice. There is a question mark, we are not so sure and no one can attest to that." – IIA

This is perhaps a consequence of externally imposed standards as they have not been formulated locally. Regulations may be more useful if they are simplified and localised; taking into account the practical reality of the capacity of the regulator and the resources it has at its disposal to enforce the laws and enact upon them. Unenforced laws reflect

poorly on the effectiveness of the regulator though it depends on the sector being regulated according to one interviewee:

“No [the regulators] have not been effective. They have paid lip service [on corporate governance enforcement]. [They have] attempted to do certain things. It depends on the sector. Regulation in banking and finance has been the most successful for a variety of reasons as the financial community is globally integrated for example with the Basel standards. And that’s the name of the game!” – private sector 4

For other interviewees though, the regulators have been more effective than in the past:

“To some extent they have been effective. The PSE and the SEC have been successful in having publicly listed companies comply with various corporate governance requirements. However, they have to be more pro-active in monitoring corporate governance compliance.” – private sector 5

“I think compared to the past years, yes [they have been effective]. Although it still requires improvement, we’re on the right direction now. They are very much monitoring corporations over corporate governance. Unlike before they just give you the regulations, now they’re very strict with deadlines, disclosure and transparency. This is a move in the right direction, we need some improvements and it’s there. They have never been strict as they have until now.” – private sector 6

“Yes, we now have effective corporate governance institutions because it was mandated by the BSP and SEC. That has been a good system for the reform movement.” – business advocate

Corporate governance reforms would have greater import and currency if it had strong regulatory oversight with private sector participation and consultation.

“There are certain limitations and weaknesses in our regulatory institutions [interviewees exchange look of despair dealing with government]. Corporate governance in general has major stakeholders. The regulators - PSE, SEC - play very vital roles in corporate governance in the country...[The] mentality of the

Philippine corporations is to follow what is dictated by the regulator. They won't follow it if it is not dictated by the regulators." – PLDT

"The big corporations are influential in their corporate governance standards but they won't drive the change. It will be the regulators and government. The change will be done by industry standards and government regulation." –private sector 7

There are expectations that regulators should and must be seen as enforcers of existing rules; and that enforcement is done without prejudice. This echoes again calls for a level playing field with regulators as impartial referees.

5.1.1 Harmonisation in Enforcement

Harmonisation of corporate governance reform and enforcement was a subject some interviewees brought up. When corporate governance reforms are enforced, one regulator may have a different view on a particular issue. A case in point is on the issue of directorships and how this is recognised as a professional qualification:

"The BSP has no Code of Corporate Governance but the BSP requires bank directors to attend corporate governance meetings and under the General Banking Act of June 30th 2000, the directors must adhere to the 'fit and proper rule'" – SEC

If a banking director is about to be nominated to an insurance company directorship, there is some divergent requirements in terms of compliance between the two regulators – that of the BSP and Insurance Commission in this case – and this may lead to problems or confusion:

"They need to harmonise the corporate governance requirements of regulatory agencies. There needs to be a common reservoir for all of this. The requirements for independent directors should be consistent amongst regulators – we are talking about the same individuals (independent directors) and the same companies. Why must there be discrepancies in the requirements? So for the requirements for director training, why should it vary across agencies for example with one or two days of training?" – ICD

A pertinent issue that requires harmonisation is the technological. In particular, the SEC is occupied by the proliferation of database and company information (see Co-ordinating the IT Infrastructure under the SEC section later in this chapter).

However, regulators are gradually dealing with their divergent requirements. To coordinate the introduction of corporate governance reforms amongst the regulators, a Financial Sector Forum (FSF) was initiated by the BSP in 2005.³⁴ The Financial Sector Forum meets bimonthly and brings together the BSP, SEC and the Insurance Commission.³⁵ This Forum facilitates discussion amongst the government regulators on how corporate governance is being implemented in the sectors under their purview and that there is proper uniformity in coordination as the main regulators in developing the capital market in the country (Espanilla 2006: 145):

“There is a Financial Sector Forum that meets once every two months and it brings together the main regulators: BSP, SEC and IC. In this forum, things like how each agency promotes good governance is discussed. It is an alignment of standards and regulations. It was established in 2005.” – BSP

Co-ordinating corporate governance reforms are a work in progress for regulators.

5.1.2 Resource Constraints

However, what affects the ability of regulators to enforce is the lack of resources - both staff and technical. While later sections in this chapter look at the specific resource issues of each regulator, the following comments are characteristic and common to all regulatory bodies.

There is a widely held belief that government needs to give more resources to the regulators so they can do what they were established to do:

“Look at it from their competencies and resources of decisions. They can’t

³⁴ Similarly, in Australia, there exists the Council of Financial Regulators which meets quarterly and coordinates the main financial government regulatory agencies. The Council comprises of the Reserve Bank of Australia (RBA), the Australian Prudential Regulatory Authority (APRA), the Australian Securities and Investment Commission (ASIC) and the Australian Treasury. <http://www.rba.gov.au/financialsystemstability/australianregulatoryframework/cfr.html> accessed 3 December 2009

³⁵ According to Espanilla (2006), the Philippine Deposit Insurance Commission (PDIC) is also part of the FSF: however I never sought an interview with the PDIC as they mostly dealt with deposits and not regulation of corporate governance.

effectively enforce the rules of the game without the right people, training and resources. The key is competencies and resources with [the regulatory] agencies. You need to enhance and require competencies...the reforms in regulatory agencies such as the PSE and SEC will be more meaningful in those agencies to shepherd corporate governance in the country and that these reforms also happens. Philippine corporations look at the PSE and SEC as the primary advocates of corporate governance here. For [wider acceptance and legitimacy of corporate governance reforms] to happen, they need to enhance their competencies and for government to give them resources. Give them the intellectual and financial resources.” – PLDT

From another interviewee, the lack of resources in the regulatory authorities is a reflection of other areas in the country that have more pressing needs in the government budget. Hence, other ways need to be found:

“You need to have piecemeal reforms and look at the bigger picture. How do you give the ombudsmen more teeth and weed out the corruption in government institutions? If you give ombudsmen power in the Bureau of Internal Revenue, give it autonomy, give it teeth. You can’t do a Lee Kuan Yew of Singapore and give high salaries to your civil servants. The country can’t afford high salaries. It has to be piecemeal, long-term reforms. Technology will help, and others.” – private sector 1

In dealing with the resource issue, some interviewees pointed out regulatory agencies only seek to regulate those who do comply with the laws while ‘failing’ to regulate those who did not. A catch-22 situation becomes extant. Therefore, those who comply will continually be the targets of the regulators and not those who do not pay tax (see also BIR in Chapter 9 Corruption):

“There is only a small percentage of companies that pay taxes. The government isn’t efficient in collecting and they only look at the visible companies such as the listed ones.” – private sector 2

It will take some time for the impression - that those who disobey the laws will not be punished precisely because there are not enough resources to pursue the lawbreakers – to be dispelled amongst the regulated.

5.1.3 Public-Private Sector Dialogue

Reflecting another unintended consequence of the hierarchical nature of coercive isomorphism is the lack of dialogue between the regulators and regulated over the introduction of corporate governance reforms. This lack of communication was touched on by some interviewees:

“Regulators may want to take a "guiding role" and thus conduct more often dialogue with listed firms on how they see a regulation to be enforced or complied with. In this way, the rules are made clear and the listed firms can zero in on the more significant improvements that should be undertaken...Generally, listed firms would at the least comply with the minimum required. I believe regulators should take an active role in significantly improving corporate governance but not with a mindset of imposing fines or penalties. Thus it is best that regulators take the mediative role of clarifying its requirements as well as helping listed firms comply through the issuance of reminders way ahead of time of the submission reports that are required.” - private sector 1

“Basically, I’d hope there will be a dialogue between the government agencies and the listed companies. [The dialogue] hasn’t been enough. I have discussed this with other lawyers the PSE rules on disclosure. They have asked us too much and the requirements are unreasonable.” - private sector 2

Consistent application of rules in the interaction between the regulators and the regulated would also help the relationship:

“Some consistency is required such as making requirements known to listed companies and don’t do anything. There are complaints with the change of rules without informing. There needs to be some consistency. As regulators, they need to be developmental with the market instead of being the hindrances. The keywords are that the regulator should not navigate but instead facilitate. This is something new to them.” – PLDT

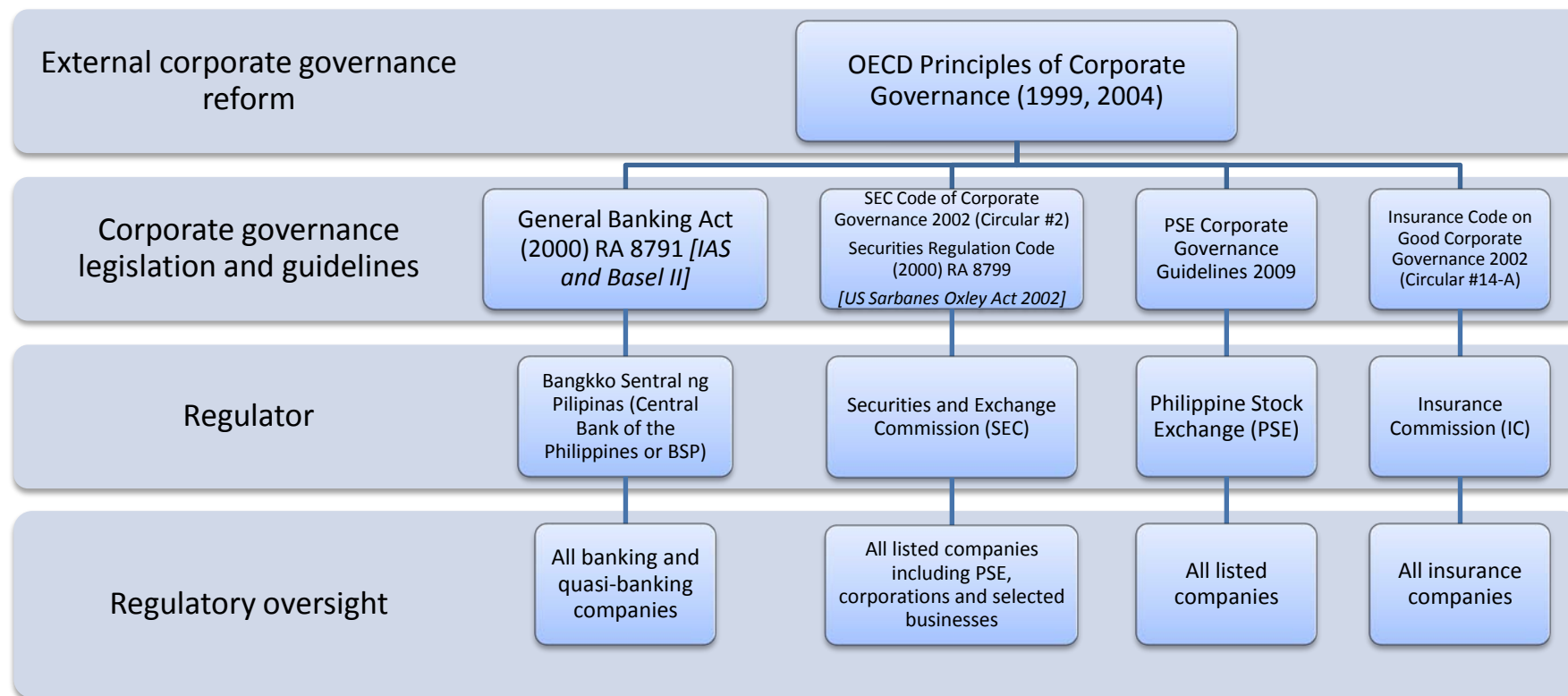
Harmonisation, enforcement and consistent application of laws will be greatly enhanced by dialogue between the private and public sector for corporate governance reforms to have wider acceptance.

5.1.3 Corporate Governance Regulation in the Philippines

This section provided the context of the local regulatory environment of the Philippines. The rest of this chapter looks at the main experiences of the four main corporate governance regulators in the country and provide a particular insight into how the OECD corporate governance reforms were introduced by the regulators in the Philippines.

The following figure summarises the role of the regulator, the sector or industry the corporate governance regulator is responsible for, and the local corporate governance reforms they have oversight of. Echanis has a similar chart on external influences on Philippine corporate governance with the additional role of the judiciary. (2006: 4) Since I did not extend my sample to members of the judiciary, I have not included it though the justice system's role is mentioned in Chapter 9: Corruption.

Figure 23: Corporate Governance Regulators and Reforms in the Philippines



The main external corporate governance reforms that have made an impact into the formulation and implementation of corporate governance in the country is the OECD Principles of Corporate Governance (1999, 2004) Supplementary external reforms that have also had an effect include the IAS, Basel II, and the US Sarbanes Oxley Act. They are italicised in the second row boxes of the BSP and SEC reforms respectively.

In summary, the BSP is the banking regulator and has oversight of all banks under the General Banking Act. The SEC is the principal private sector and corporate governance regulator under the SEC Code of Corporate Governance 2002. This SEC Code is the main corporate governance regulation in the country. The PSE has oversight of listed companies and issued its own guidelines on corporate governance. Finally, the Insurance Commission has oversight of insurance companies and has issued its own code of corporate governance. The next sections discuss each regulator's experience of corporate governance regulation in the country.

5.2 Central Bank of the Philippines

The Bangko Sentral ng Pilipinas (BSP) is the Central Bank of the Philippines. The BSP is the country's central monetary authority and is divided into three functional divisions: monetary stability, supervision and examination, and resource management support.

The BSP has six main responsibilities: liquidity management, currency issues, lender of last resort, exchange rate policy, foreign currency reserves and financial supervision. This last responsibility is the one closely linked with its role in promoting corporate governance reforms in the country and building public confidence in the financial system:

“Amongst the mandate of the BSP is to foster an environment that is conducive to the financial stability system of the country. Within the banking industry, corporate governance is necessary. We promote banking in trust. If the public has no trust in the public sector, then they would not use the industry. As the banking supervisory regulator, we have issued regulations to promote corporate governance.” - BSP

The BSP's financial supervision allows the institution oversight over the “operations of banks and exercises regulatory powers over non-bank institutions performing quasi-

banking functions.” (BSP 2009b)

5.2.1 Independence and Autonomy of the BSP

At the heart of a capital-market based economy is an independent central bank. A central bank that is depoliticised and acts independently promotes economic stability. An independent central bank decoupled from political events promotes or improves real economic performance:

“...an independent central bank may serve to insulate the economy from political business cycles either by preventing pre-election manipulation of monetary policy...or by reducing partisan shocks to policy following elections.”(Alesina and Summers 1993: 152)

The BSP has “fiscal and administrative autonomy from the National Government” (BSP 2009c) which has allowed this regulator a degree of autonomy and independence not found in other government institutions. The BSP is in an enviable position relative to other corporate governance regulators. The BSP is subject to less political interference and this distinction is important. Autonomy represents a great amount of flexibility in fulfilling a regulatory institution’s mandate. Autonomy also represents stability. This makes an enormous difference in the sometime highly politicised environment of the country:

“The BSP is one of the more professional organisations [in government]. The levels of compensation [there relative to others is high]. It is fiscally independent. That is a big advantage. It is easier to make pioneering reforms. For example, [a particular reform] was easier to do through the BSP than the Ministry of Finance.” – former public servant

Another interviewee pointed out the BSP governor’s position is less influenced by the political appointment system that is prevalent in the country’s public service. This allows the regulator to do what it is supposed to do without fear of retribution:

“It is the exception rather than the rule: the BSP Governor’s tenure is fixed-term by law. If there is a change of presidential administration, he can’t be replaced but can resign voluntarily. For other agencies, it would require an enabling law to

make fixed terms but this would restrict [the Philippine President's] ability to change at the top." – private sector 1

However, this has not always been the case. Why a strong, well-resourced and independent central bank is important in a developing economy environment is related in the next section which looks at the bank's experience under Marcos.

5.2.2 The BSP under the Marcos dictatorship and Hutchcroft's Booty Capitalism

The Philippines has experienced immense periods of political instability in the last 50 years. For the public service, riding out the turbulence is a matter of survival. To ensure the public service keeps functioning despite or in spite of the political environment is a hallmark of a strong civil service. Unfortunately, for the most part, the Philippine public service has yet to achieve this wall of separation between the politics and the bureaucracy. It is worthwhile to recall the experience of the BSP during the dictatorship of Marcos. Almost all government institutions were negatively impacted by the dictatorship. The BSP was no exception.

Paul Hutchcroft's 1998 excellent book *Booty Capitalism: The Politics of Banking in the Philippines* provides the context and history of banking regulation in the country. Hutchcroft's monograph an account of what happens to banks when there is a weak and authoritarian state with some predatory elites. Unlike Thailand where there is a strong, well-compensated bureaucracy that is relatively independent, public sector employees in the Philippines are subject to undue influence. Hutchcroft documented the particular challenges faced by the BSP over its supervision of the industry and his account is centred on the interaction between the regulators, the regulated, and the political masters of both. In particular, he notes politically well-connected bank owners regularly undermined the independence of the bank's regulatory and supervisory capacity, while courts generally sided with the bank owners:

"Bank owners express outrage if they are investigated by the Central Bank, and expect bad and fraudulent loans to be overlooked. The Central Bank threatens, but fails, to prosecute bank owners for violation of its regulations. Courts declare the Central Bank to be arbitrary in its treatment of a given bank, and castigate it for not offering sufficient assistance to ensure a bank's survival (even errant banks are not to be liquidated), because such a process would undermine the

confidence in the banking system that the Central Bank is duty-bound to preserve. In later years, those who nonetheless lose their banks commonly point to appreciation of their assets (especially real estate holdings) to argue that their banks are no longer insolvent and should be reopened.” (1998: 101)

The Central Bank’s role under the Marcos dictatorship became that of a facilitator for Marcos’ cronies and friends. Hutchcroft detailed 12 instances of state-sanctioned expropriation of banks that benefited Marcos and his friends.³⁶

Previous BSP governors were also subject to legal actions brought against them personally by owners of companies they were seeking to regulate. Such lawsuits undermined the capacity and willingness of regulators to regulate. Coupled with the widely held perception that the judicial system of the country is corrupt, lawsuits against regulators are seen as highly politically motivated. Regulatory chiefs in other government institutions are also subject to legal actions even if their decision making was discharged in a professional capacity. The following interviewee relates the example of such a suit:

³⁶ “Some twelve banks – almost all of which were in a weak position – ended up in the hands of Marcos and his cronies:

1. Continental Bank was reopened as *International Corporate Bank* (italics included) under the control of [Marcos] crony Herminio Disini.
2. Pilipinas Bank of crony Ricardo Silverio was kept alive with generous equity assistance from state banks.
3. Jose Cojuangco’s First United Bank was purchased by his nephew, Eduardo ‘Danding’ Cojuangco, on behalf of the Philippine Coconut Authority and with funds provided by the coconut levy, renamed United Coconut Planters Bank and controlled by a small group centred on Cojuangco (see also Askew 2005)
4. Genbank became Allied Bank, under a group of investors led by Lucio Tan
5. Emerito Ramos eventually sold Overseas Bank of Manila to a group close to Herminio Disini, which renamed the bank Commercial Bank of Manila.
6. The Philippine Bank of Communications was steadily acquired by a group of investors led by Ralph Nubla, the main liaison between Marcos and the Chinese-Filipino business community.
7. Controlling interest in the Philippine Commercial and Industrial Bank of the powerful pre-martial law clan of Eugenio Lopez was assumed by regime interested led by Benjamin ‘Kokoy’ Romualdez (brother of Imelda Marcos)
8. Philippine Trust Company ended up in the hands of Emilio Yap, a friend of Imelda’s family.
9. Philippine Veterans Bank, nominally owned by World War Two veterans and almost entirely beholden to the government for support, had most of its shares ‘held in trust by the veteran with all the bogus medals, Ferdinand Marcos
10. Republic Bank was transferred to Roberto S. Benedicto, a fraternity brother of Marcos who was head of the Philippine Sugar Commission, and renamed Republic Planters Bank.
11. Trades Commercial Bank also went to Benedicto, was renamed Traders Royal Bank, and used to handle financial transactions for the regime.
12. Security Bank, reportedly came to be controlled by Marcos himself, and took major responsibility for the president’s personal financial transactions.” (Hutchcroft 1998: 137)

“If I were to make a recommendation it would be to limit legal suits brought against public officials in introducing reforms while in public office; there needs to be a limit on the legal liability against public officials. BSP governor Fernandez had to adopt draconian measures for all banks. This was challenged by a legal technicality in the courts. Under Philippine law, public officials are responsible - personally liable for official acts. That is, your personal assets are on the line such as your property if there was a suit. The former Governor’s own estate was attached to the court action. He had to pay legal fees. The BSP, the DPIC (Deposit Insurance Commission) - they are the institutions vulnerable to these challenges. The system’s corrupt. The stakes are high.” – private sector 2

Recovery from this period of turmoil and havoc continues to this day however the BSP’s rehabilitation has been quicker than most other government institutions.

5.2.3 A Better-Resourced Regulator

For the institution and people within the institution, the growing independence of the BSP after the turbulence of Marcos is a welcome change. My interview observation notes bear the difference of this change in terms of the resources between that of the BSP and SEC have at their disposal. The former is well-resourced, the latter is not:

“I arrived at the SEC early for an 8am interview. The SEC was established in 1936. The offices aren’t as well resourced, not as neat and tidy as some of the private sector buildings. The lifts took awhile, there was no air-conditioning within the offices and people used fans. But the office I went to was already busy with people despite the early morning. My interviewee was busy typing on her laptop when I arrived and our interview was interrupted by various calls, including one discussing the recent election. During our meeting, we kept being interrupted – or a timely reminder of our location – by the passing of the trains. The SEC is located next to the main road leading in and out of Makati (EDSA) and the railway line.” – SEC observation notes

“Compared to my interview at the SEC, the BSP is like a palace in a salubrious complex. Marbled floors, tight security, it is indeed a well-resourced government agency in comparison to its poorer cousin. Also one could see the ever present signs of Catholicism in the country. Walking through the connecting floors that

led to one BSP building to another, there was a floor-to-ceiling crucifixion in one corner with burning candles at the foot of the cross. The offices of the Assistant Governor were filled with valuable Filipino art paintings, one by Fernando Amorsolo. There was also some ethnographic artwork from Mindanao including some ceremonial music instruments which I took for Thai ethnography. There were around 4 office assistants...We sat around a padded leather table. Though the leather was chafed and worn, the furniture displayed wealth. The Reserve Bank of the Philippines is a well-resourced agency.” – BSP observation notes

5.2.4 Crisis and Reform

The aftermath of crises became catalysts for banking reform. The fall of the Marcos dictatorship saw extensive political reforms while the East Asian Crisis prompted structural reforms. Extensive rehabilitation followed after Marcos’ departure especially for state-owned banks (see DBP section in Chapter 8 Government Financial Institutions):

“Before, there was a bias in the law in favour of owners. A long time ago banks were a monopoly. Banks knew little about corporations they were lending to. Banks didn’t know bad accounting and so forth. Banks were only agents, as channels of capital. But that is not the reality now.” – private sector 1

While the East Asian Crisis showed Philippine banks could no longer operate in isolation nor could it be buffered in an era of financial globalisation. The following account relates what happened in the aftermath of the East Asian Crisis:

“The banks accumulated a lot of non-performing loans (NPLs). Post-crisis, there was significant deterioration of the [currency] *piso*. Currently the *piso* is still low and has not rebounded back to its pre-crisis level. It was once 53P to USD1 and now it is P45. The recovery is significant but it still has not recovered. There was also a lot of default from customers. Before the East Asian Crisis the banks became very aggressive with foreign currency loans. Afterwards, they couldn’t pay their obligations so there were a lot of foreclosures. The banks accumulated lots of non-performing assets. Compared to the rest of the region, the (NPLs) were not that bad. In the Philippines before the crisis it started with single digit NPLs, but it reached 16 points during the crisis but it is back now to high 6/low 7 NPL.” – BSP

The East Asian Crisis exposed participants in the banking industry separating the well-run banks from the not so well run banks.

“Banks are reliant on the capital markets now. Previously you could suppress the real value of a bank. The banks were in denial. The capital market was not holding what was its actual worth. The financial regulators were moving towards a way to price assets against a mark to market system. The BSP knew what crazy things banks were entering into with their risk capital. Now, it depends on who the banks are lending to. Previously, it was lending to somebody affiliated with a bank. Most of the big banks are now listed and there is greater independence between the capital market and corporations and banks. Now the banks need to work more closely with the regulators.” – private sector 2

Anecdotally, one major bank rode out the East Asian crisis as it was highly capitalised although its practices were suspect. This crisis became a catalyst for the bank to improve its corporate governance practices. For another, out of the crisis came opportunity. At least one large commercial bank acquired a couple of its smaller rivals during the East Asian crisis:

“During the crisis, we took advantage of several opportunities. We acquired banks and we were aggressive in doing this during the crisis and we took advantage of these opportunities. Smaller companies had a hard time, and they merged with other companies. There were two banks that merged with [the bank] during the crisis.” – business group

One outcome of the crisis was greater emphasis on the veracity of externally audited financial statements. The BSP sees public reporting of the financial health of banks as a key component in determining the quality of corporate governance in banks:

“Financial statements audited by external auditors for [companies regulated by the BSP, IC and SEC] must contain documents that vouch for what is contained in the financial statements. The BSP requirements are quarterly statements from the commercial listed banks and they must be published in the newspaper. For the smaller rural banks postings of information within the premises and other conspicuous places with the communication cc’ed to the BSP.” - BSP

Within the BSP itself, several board committees were established after the East Asian crisis. An audit committee was established in the latter term of former BSP Governor Buenaventura and there is a risk management committee at the monetary board. A corporate state planning committee was also established under Buenaventura. This committee looks at medium to long-term planning for the BSP.

The corporate planning committee is guided by a 5-year plan with the last round being the period 2004-2011. Issues of corporate governance and how it is looked in the medium term is part of this committee's purview. The committee presents to the monetary board what has been accomplished over this period such as meeting milestones, formulating strategies and noting the bank's key stakeholders. Apart from supervision, other issues include price stability, inflation targets and financial literacy. Financial literacy amongst depositors is a pressing issue in the country:

"On financial literacy, the consumers are just used to traditional deposits and other banking products are not well known. We promote a certain amount of financial literacy in coordination with the SEC, IC, an NGO called EPRA (based at Ateneo) on Economic and Literacy. It is an issue with the Financial Sector Forum and literacy starts with school children." - BSP

In contrast to the East Asian Crisis, the 2007-2008 global financial crisis had a more limited impact on the country. Some major banks had limited exposure in American investment bank Lehman Brothers which collapsed in 2008, however, unlike the East Asian Crisis, previous banking reforms in the industry (see Basel II reforms later in this chapter) had buffered the major companies and were in a stronger fiscal position to ride out this crisis (Rimando 2008). Nevertheless, the country still has some way to go with its banking reforms such as setting up a credit reporting facility. The lack of this facility is a reflection of the reluctance by companies to disclose information, a point underlined by one interviewee:

"It's an issue with pride and greed. Having a credit bureau is a practical manner. [The obstacles to it is] attitudinal. [There is plenty of] inquiries by foreigners but companies do not want to give information. There is a lack of [company] information." - private sector 3

Supporting this interviewee's advocacy, in July 2009, the Chief Economist of the World

Bank, Justin Lin, wrote a wide-ranging article for the Economist. Included was advice to establish a credit registry or bureau to encourage start-up businesses in developing countries (Lin 2009).

5.2.5 The Rural Banks

Due to their scale, scope and size, big banks can generally survive a crisis through a merger or acquisition. However, the effects of a crisis are magnified with smaller banks that are not as well-established, as large or as professional.

The East Asian Crisis badly affected the rural banking sector which remains the bedrock of financing in the rural provinces of the country. As a largely agrarian society, the closure of rural banks has had a ripple effect in their communities. For the BSP, the corporate governance structure of some rural banks made them prone to unprofessional practices. Echoing Hutchcroft's observation of the then unprofessional larger banks, the small banks are largely mired by the inherent conflict of interest of owner-borrower. Rural bank owners still have the propensity of treating their banks as personal piggy banks:

“There are around 80 thrift banks and there are 700 rural banks. There are 11,000 branches across the country. In terms of [banking] failure it was not caused by the [East Asian] crisis. The number of failures of the rural banks was due to governance and mismanagement. Most of the rural banks are owned by families and they were the operators and sometimes the borrowers. At the end of the day they couldn't collect.” – BSP

The BSP is preoccupied with proper regulation and supervision of rural banks and should a bank become non-operational, the exit strategy comes into play:

“With rural banks, we follow the core principles and improve the information system so there's an early warning system. If there are red flags we can take prompt corrective action. We try to bring the bank back to its healthy status. [If not], we try to make the 'exit as orderly' as possible.

“So with some rural banks that are currently problematic, they are identified, [made to take] prompt corrective status, and [sign a] memo of understanding (MOU) with the BSP from their directors and head of our sector. The MOU

contains a list of positive measures which makes the problem bank commit to undertake in a timeline to improve its governance, its capital position, business improvement, decrease its non performing loan ratio, and reduce costs.” – BSP interviewee

The BSP’s preoccupation with rural banks and how to reform is not uncommon amongst developing economies. Reforms requiring simple solutions to simple problems rather than complex solutions for the developing country context ought to be emphasised. (Lin 2009) One private sector interviewee suggested the audit of banks can be more streamlined by outsourcing it to the private sector:

“The [job of] BSP auditors can be done by the private sector so audit of banks can be done better. There are several thousands of rural banks and only the BSP [is auditing them]. [If the private sector does the audit] it would reduce some of them bureaucracy.” – private sector 1

Furthermore, the GFC also exposed the continuing issue of the governance of rural banks:

“The major banks are pretty sound here, although a few rural (small) banks have gone bust on bad loans, practices and fraud – [they are] now being exposed.” – private sector 2

The reform process in the Philippine banking industry continues and has gone some way to address the issues that arose from the Wild West environment of Hutchcroft’s account. However, there is still a lot to be improved in the industry.

5.2.6 Introducing Corporate Governance to the Banking Industry

When corporate governance reforms were introduced, it was the Philippine banks that were first exposed to the main corporate governance reform of independent directors. The Philippines has a largely bank-based model of financing as the capital market is still underdeveloped. (see Chapter 6 on Financing). The key to introducing corporate governance in the country was and continues to be in the banks. Any ongoing reform in the real private sector occurs in this industry for banking is at the coalface of corporate governance.

The regulator of the industry takes a pivotal role in ensuring corporate governance reforms are implemented by players. The mandate given to the BSP to oversee the reforms in the industry is through the General Banking Act of 2000 (or Republic Act 8791). Emphasising corporate governance is principally due to the need to engender public confidence and promote disclosure:

“We have tried to promote governance beyond banking. There is a circular which requested banks to give their clients, to submit documents such as audited financial statements.” - BSP

Banks are required to have a corporate governance manual that operationalises and applies key corporate governance principles. The following bank set up a corporate governance committee to deal with compliance requirements:

“[The] BSP used to audit financials but now zero-in on corporate governance (CG) and risk management (RM). CG and RM are now integral parts of their regulation. The BSP makes each of the directors attend two-day seminars to improve corporate governance amongst officers – corporate governance for the board and directors but also for officers...

“[We have a] corporate governance committee which implements separate scorecards in rating how well each director observes governance principles. By mandate, the corporate governance committee meets and reports regularly. In the scorecard we rate the board of directors, rank individual directors and rate ourselves and the corporate governance committee. [These scorecards] evaluate the performance of the board, individual directors, board committee and top management. [It also covers] appointment of officers, and whether the bank adheres to ‘fit and proper’ rule mandated by BSP. As a result of the regulatory requirements of the BSP, we now have adopted the Corporate Governance Manual (2002) and a Corporate Governance Charter (2005)” - bank 1

The corporate governance manual was subject to some revisions by the regulated banks to adapt it to their set of circumstance. As a result, some were challenged in trying to fulfil the BSP’s requirements:

“Our first manual on corporate governance was introduced in 2003 and is 20 pages long. The basis of this manual was the BSP’s which came up with a model

manual in 2002/2003. We patterned the 2003 manual after that. However the model manual was mostly applicable to commercial banks. In 2006, the manual was revised and is now 22 pages with 5-6 pages of appendices. The revisions took into consideration the bank's position as a state-owned enterprise and the constraints involved and the set up of how we are organised and to make sure that the principles of corporate governance is covered by this manual. In the 2006 Manual, there are two attachments. The first annex is the Self Assessment. The second annex is the rating system." – bank 2

"[With the manual] if the scoresheet was unacceptable to the BSP or they say it's not good enough, we would ask them to give us a sample but they never did provide a sample. They would just say it's too superficial." – bank 1

Verifying requirements, such as the self-assessment of directors, is an organisation-specific matter allowing the bank's board to reflect on whether corporate governance is being implemented effectively. Overall, there is a positive opinion of the BSP amongst interviewees. The banking industry is core to the private sector financing of the country and the regulator must be adept at noticing any defects in the system at first instance:

"At the BSP there is a basic fact of high level of corporate governance standards."
– private sector 1

However, one interviewee wanted more consultation from the regulator instead of an "obey or be punished" approach when introducing reforms:

"The BSP is purely regulatory, and it is not doing their job as an administrator. [They say] this is the rule, follow it. We the regulated would wish they could help us 'do the right thing'. The feeling in the private sector is – do the rule, follow it, violate it and there is a sanction. Show us the way on the rule. On corporate governance, we are taught the duty of obedience, follow the rules. Here is a street, there is no pedestrian crossing, the policeman will tell you, go to this side, cross here. The BSP on the other hand says do not cross here, it's up to you to find the way. They know the rules. Teach us how to do it." – bank 1

Externally generated corporate governance reforms in the banking industry will continue to be adapted as long as the standards are formulated externally and interpreted locally.

5.2.7 The ICD and Professional Director Training

The corporate governance requirement of having capable, qualified independent directors was implemented in the Philippines in large part due to the ICD with backing and support from the BSP. Indeed, the ICD is credited for having the material from which the BSP policymakers based its circular:

“...there are cut and paste circulars that are issued from the BSP but which are the exact issuances from the ICD given to the BSP. For example, we issued a 2006 Policy Paper in February and the BSP circular in September was an exact copy of our 2006 policy paper.” - ICD

In introducing the idea of having professional qualified directors on company boards, the ICD understood the importance of banks in the overall private sector environment and financing structure of the economy. The ICD initially targeted the banks to introduce director training:

“So how did we introduce corporate governance reforms? The Central Bank of the Philippines with a tremendous amount of goodwill for my founder (Estanislao was the former Chairman of the Monetary Board) it was not very difficult for us to mean well. They opened up to us through policy recommendations where we introduced certain concepts which the BSP have welcomed. There were circulars and we got the message across to them the importance of good governance.

“Thus, the ICD had a good opportunity to train the commercial banks and develop the banking system. Before and after the East Asian crisis, the Filipino banks were not affected. They were still there before and after although there was some consolidation. They were not as affected because they were detached from the brunt of the crisis unlike Indonesia. The banks were too detached regionally thus they were not affected. However, that did not tell them that they had good governance.

“The BSP introduced a two-day compulsory corporate governance training for bank directors. This strategy was aimed at bank directors because it was important to inform banks the importance of corporate governance since they

placed such a central role in the commercial industrial groups (CIGs). Once the banks knew, then it would filter through the rest of the CIGs. This two-day training in 2002 was not met happily by directors who wondered who were these upstarts who influenced the BSP to introduce the training. The bank directors had a choice of eight training providers but all chose the ICD.” – ICD

The key support and cooperation from the BSP provided the impetus to introduce corporate governance reform that became a requirement in the country:

“The Central Bank is the most advanced regulatory agency on governance and related issues. There is a committee group on board, the resources [in the BSP] are there, control is important in the sector and the law allows them want to do. The BSP gets things done.” -ICD

“We require banks to undergo a two-day orientation in corporate governance. The first day is on concepts and principles of corporate governance. The second day is on risk management. The BSP developed certain accreditation guidelines to train the directors.” – BSP

The standards for a bank directorship have now improved due to the professional training required for this position. A bank directorship also carries with a ‘fit and proper’ rule for the candidates, which is not required in other industries:

“There is a ‘fit and proper rule’ which has a list of qualifications and disqualifications for a banking director that was articulated in the General Banking Act of 2000. Prior to that when bank directors were elected, senior vice presidents and over have to be confirmed by the [BSP] Monetary Board processes. One had to show that age limits were being met: 21 years of age for an officer, 25 years of age for bank president. One has to possess none of the disqualification and not be temporarily suspended. Furthermore delinquencies should not be found....Director and officers must meet the fit and proper rule or they get disqualified. Banks must have compliance officers to ensure that banks are meeting their director requirements. The two-day corporate governance seminar is but to whet their appetites. Then it’s left to [the banks] to identify the gaps – all the way down the organisation ladder. That’s enough to assess the quality of management.” – private sector 1

“In corporate governance, to be a director of bank, the BSP will check you first according to the fit and proper rule. They will do a criminal check on you. The SEC won’t do a check on [a director of] an ordinary corporation but the BSP does due to the special nature of fiduciary [responsibilities] of a financial institution.”

– private sector 2

The training of bank directors has also seen the banks being the first to host independent directors or have independent directors sit on company bank boards in excess of the legislated requirement:

“The ICD promoted corporate governance in banks with the BSP requiring directors to go through a corporate governance seminar. More independent directors have joined the banks - mostly in the banks.” – private sector 3

However, one bank director was dissatisfied with the current training requirements and other corporate governance mandates, recommending these reforms be far more explicit and wide-reaching:

“One has to evaluate the performance of the board, individual directors, board committees, top management, the appointment of officers, and that the bank adheres to ‘fit and proper’ rule mandated by BSP. There was the BSP requirement which meant completing a two-day seminar to be a director. The BSP required all bank directors to attend the day seminar and it was accredited by them. For corporate governance, initial steps have been taken, something more should be done so corporate governance filters to other family businesses. Family-owned organisations observe BSP rules but not corporate governance. When I lecture before them, it’s [corporate governance] all Greek to them. They do not know the liabilities of directors. The BSP makes each of the directors attend two-day seminar to improve corporate governance amongst officers – corporate governance for the board and directors but also for officers. We require more materials such as publications, reading materials. The SEC has a Code of Corporate Governance but is addressed only to listed corporations. But all corporations, whether they are listed or unlisted, open or closed, should have the Code applied to them. Somebody should be in charge e.g. the ICD. How about the small companies? For example, the SEC could observe them.” – private sector

Professional director training in companies is a relatively new phenomenon in the country and there remains some resistance to this requirement. However the benefits of having a professional director are now being recognised.

5.2.8 Basel II Standards

Aside from the OECD Principles of Corporate Governance that have become – through a combination of coercive and mimetic isomorphism – operationalised in the country, the BSP follows closely the comprehensive 2006 Basel II Framework on capital standards³⁷ which are specific to the banking industry. In the aftermath of the 2008-2009 global financial crisis, the framework lays out the “International Convergence of Capital Measurement and Capital Standards” (BIS 2009a) which seeks “to align regulatory capital requirements more closely to the underlying risks that banks face.” (BIS 2009B)

The standards are overseen by the Bank for International Settlements (BIS) located in Basel, Switzerland. For the BSP and other central banks in the world, compliance and implementation of Basel II are a main preoccupation. There are three pillars underlying Basel II: minimal capital requirements and calculation of risks for the financial institution in concern; the supervisory review process undertaken by the Central Bank and the third pillar of market discipline. How to implement mutually agreed upon global standards locally are done step-by-step with the standards providing guidance to the BSP in terms of which aspects of the banking system require monitoring:

“There has been a marked improvement of risk management in the banks. The emphasis in supervision is we’ve changed our conduct of bank supervision. We follow the principles issued by the Basel Committee for Banking Supervision. We are following a risk-based approach and looking at the strength of risk management. We look at processes, the effectiveness of internal audit, and the compliance function rather than focusing on transaction. We look at compliance but this is secondary to processes and accreditation is part of the training process.” - BSP

The early implementation of these reforms has generally improved the capital positions of Philippines bank. The Basel II reforms are also indicative of how the banking

³⁷A list of the BSP’s implementation of the Basel II reforms can be found in the following page: <http://www.bsp.gov.ph/regulations/implementation.asp> accessed 20 November 2009

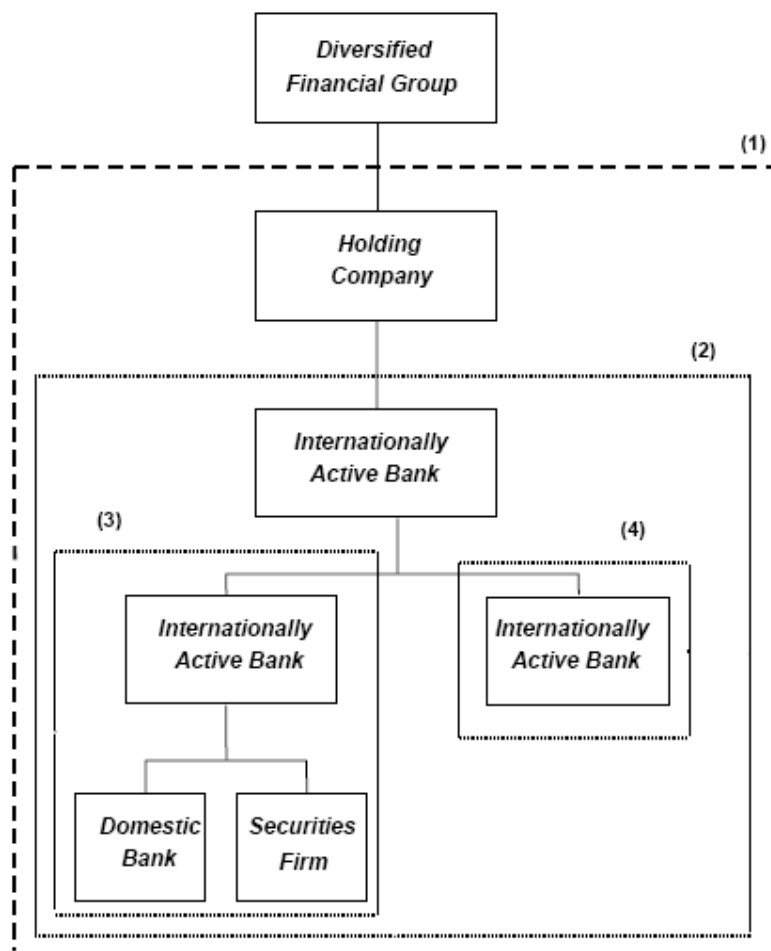
regulation in the country will be shaped in the future:

“With corporate governance we have kicked-off with the OECD requirements [and then] for risk-based capital adequacy of Basel II.” – SEC II

A key element of the Basel II is the application of these reforms to the different types of corporate structures. In the case of the Philippines, the country’s private sector is largely dominated by diversified business groups with a bank at the core of the group’s operations (see Chapter 6). The applicability and scope of the Basel II framework to complex structures is illustrated by the following illustrated excerpt:

Exhibit 7: Applicability of Basel II to Financial Groups (BIS 2009a:11)

ILLUSTRATION OF NEW SCOPE OF APPLICATION OF THIS FRAMEWORK



(1) Boundary of predominant banking group. The Framework is to be applied at this level on a consolidated basis, i.e. up to holding company level (paragraph 21).

(2), (3) and (4): the Framework is also to be applied at lower levels to all Internationally active banks on a consolidated basis.

With reference to corporate governance within Basel II, risk management is largely seen as part of senior management's responsibilities. (BIS 2009a: 97-98)

5.2.9 BSP and Currency Circulation

Apart from banking supervision, there is another pressing issue for the regulator. For the BSP, there exist practical problems with the circulation and lifespan of the currency which are related to current social and geopolitical issues.

Philippine bills are frequently substituted for paper with notes being heavily marked during the course of its life. The BSP is keen to promote a 'clean note policy':

"The problem with Filipino bills is people like to mark and draw on the bills. We want to promote this policy so that they don't write and draw on it, and take care of it. It's difficult because in public markets, especially the wet markets, the lifespan of a bill and note is shortened. It doesn't happen in groceries. In Manila, the note tends to have a longer life. But in the provinces, when used in the public market, for fish or meat, when the currency gets wet, the bills don't last long." - BSP

The other issue is the metal coins in circulation. The coins are melted and used in the ongoing separatist warfare being conducted in parts of the Mindanao region, and curiously enough, as substitutes in Japanese casinos:

"Should we promote metal coins [in lieu of clean notes]? The metal coins are expensive to produce. With the coins, people tend to hoard it hence we are promoting their return to public circulation. The 10 peso coin has different metals in the inner and outer ring. Hence, we have a coin drive to retrieve the coins. In Mindanao, the 10 peso coins are used for bullet casings. In Japan, they are being used as casino chips." -BSP

Similar to other corporate governance regulators, for the BSP responsibilities of market supervision are tempered by the reality of dealing with the particularities of the daily issues of the country.

5.3 Securities and Exchange Commission

The Securities Exchange Commission (SEC) is the principal regulator supervising the

private sector of the country. Based on the US equivalent and founded in 1936 during the American colonial era, the regulator was reorganised in 2000 and has around 500 employees. The SEC's powers and responsibilities of oversight are set out in the Securities Regulation Code (SRC) or Republic Act 8799 (SEC 2009b). The SEC's mission is "to strengthen the corporate and capital market infrastructure of the Philippines, and to maintain a regulatory system based on international best standards and practices that promote the interests of investors in a free, fair and competitive business environment."³⁸ (SEC 2009)

5.3.1 SEC Corporate Governance Code of 2002

Introducing corporate governance reforms is part of the SEC's mission to incorporate international best standards and practices. The main thrust of these reforms is codified in the SEC Code of Corporate Governance of 2002. (SEC 2009c) This Code was established with advice from stakeholders and modelled after the OECD 1999 Principles:

"The new Code for the SEC SRC came into 2001 with implementing rules and regulations. We were preoccupied with the new rules in place. [At the same time] corporate governance became a beginning trend. The former SEC Chairwoman Bautista, picked up the idea from attending conferences and when she came back we started working on it. Bautista is now an independent director of the Bank of the Philippine Islands and RFM which is owned by the Concepcion Family." – SEC I

"The SEC was taking best practices from all over the place Malaysia, Singapore and other environments and was not tailored after the USA SOX as SOX came after Circular II. The SEC circular was in April 2002, SOX came in July 2002. The IIA was involved into drafting the circular. It was asked to participate by giving input in the financialisation aspects of the draft such as internal control, internal auditors." – IIA

Corporate governance reforms were part of a wave that swept the world in the early 2000s in the aftermath of the East Asian Crisis and the collapses of Enron and Parmalat. For the SEC, awareness of what was happening in the region made it realise that sooner, rather than later, the regulator needed to start incorporating these reforms as well. The

³⁸ SEC (2009) Home Page <http://www.sec.gov.ph/> accessed 26 November 2009

realisation on how corporate governance was going to affect the regulator and the regulated and the momentum this generated:

“The awareness of corporate governance at this point is at a level at which it is not yet at the level of which we could be. Given a range between 1 (low) to 5 (high awareness) the level would be up to 4 in which we would in effect have greater acceptance. We have information now and there is the emotion of urgency and that desire to be able to move [corporate governance] along. The time of awareness was from 1997-1999. There was awareness in the capital market which confused a lot. [Corporate governance] created confusion because [the market] was not sure what they were being made aware of...[eventually] we were made aware of it.” –SEC II

Introducing the reforms by the SEC was made with some trepidation and not without controversy. For the SEC, last minute injunctions against the Code’s introduction were being anticipated. However, the regulator believed in the effectiveness of the reforms as a matter of ethics and competition:

“When we first started making forays into corporate governance, we were waiting for a group of lawyers to take the SEC to the Supreme Court to stop us from instituting corporate governance but they haven’t done so. We knew though that if the suit went ahead, how can the Supreme Court decide against us? How can they rule against ethics? We cannot leave Philippine corporations uncompetitive. If the Supreme Court ruled against it, we can always require the PSE to do so because the PSE has listed companies and the listed ones comply.”- SEC I

The application of a largely Western concept has also been localised with a value-based approach paralleling the religious observations of the country:

“[Governance] is not a novel contrivance to make our lives more complex. What is transparency and accurate disclosure but the commandment Thou shalt not lie? What is shareholder value but the commandment 'Thou shalt not steal?'”
SEC Commissioner Cueto in Estopace (2007)

The Code covers the responsibilities of the company board and management, information disclosure, transparency, audit, and interests and protection of shareholders’

rights. The Code covers the majority of large private sector participants:

“We regulate listed corporations. The Corporate Governance Code covers public corporations (registered issuers; companies with more than P50M in assets; those with more than 200 shareholders each one holding 100 shares each) those unlisted but come under securities regulations. For the bulk of corporate registrants, we only supervise them in that they have to submit general information sheets and audited financial statements. With listed companies we cover those on the PSE (around 240), 35 public corporations and 41 mutual funds (registered issuers). Secondary licensees are covered by the Code. The Code of Corporate Governance governs them.” – SEC I

“[The SEC Code] has oversight depending on the size of companies. Not all companies have audit committees. Big listed corporations, public companies with big shareholders base, 200 members with 100 shares totalling P50M are required to have audit committees and are subject to the same circular...but partnerships are not covered.” – IIA

Similar to the seminars for banking directors (see previous section on BSP in this Chapter), the SEC also requires company directors to undertake some formal corporate governance training:

“There is a corporate governance seminar everyone has to undertake when every director is appointed. It came in as it’s a requisite of the SEC. For the SEC it’s all directors. The seminar is a bit light compared to [other courses I have taken in other countries].” -private sector 1

For one interviewee, he would like to see the Code applied to other private sector entities:

“The SEC has a Code of Corporate Governance but it is addressed only to listed corporations. But all corporations, whether they are listed or unlisted, open or closed, should have the Code applied to them. Somebody should be in charge [of implementing the Code] such as the ICD. How about [applying the Code to] small companies? The SEC could observe them.” – private sector 2

Unlike other jurisdictions where corporate governance has a principle-based approach,

the Code is a form of a black letter law:

“We [hope we can] get to amend the Corporation Code a lot faster...we are waiting for Congress to resolve it. We will try our best with amendments which includes a recommendation relating to corporate governance. In the Securities Code [one amendment would have] more independent directors and the ‘fit and proper rule’ for directors to be institutionalised in basic law.” – SEC I

Having a rules-based approach on independent directors reflects this as the most controversial corporate governance reform and a source of tension in the country (see Chapter 7, section on Independent Directors). For Philippine corporations, opening the board to outsiders and introducing independent directors needed a sledge-hammer approach from the regulator.

5.3.2 Corporate Governance Manual

Companies covered by the Code are required to adopt a corporate governance manual. For companies that fail to produce a manual, financial penalties apply. The penalties are there to encourage companies to take up and formalise corporate governance processes within their organisations:

“The SEC issued the Code of Corporate Governance more for diagnostic purposes. Then we came out with the Model Manual of Corporate Governance which was based on the Code. But the SEC’s intention to make the available model, look at them, look at the principles and practices and apply to them (companies) to make adjustment as not all corporations have the same situation. Instead of going over the manual, we simply compare it with the text of the manual. If we find there are inadequacies, we ask them to make the necessary adjustments and file the new manual with us. On the certification of the compliance officer, the Philippines is like other countries, changes can be made in the manual of corporate governance. The corporate governance manual should not be static due to the changing business environment. If there are deviations from the manual, the companies must explain to us why. If in practice the principles are not workable, they have to advise us with the amendments.” – SEC II

Companies I interviewed generally spoke about operationalising the requirements and compliance with the manual (specific issues over the manual's requirements are set out in Chapter 7 on Independent Directors):

“Yes. The company has created a code of conduct for all employees. It has also set up various board committees composed of board members, such as an audit, compensation, nominations, and investor relations committees. The company also has two independent directors in its board. Under the manual of corporate governance of the company, an independent director must be a member of the audit, compensation and nomination committees.” – private sector 1

Adoption of the manual emphasised the board committee structure (see also Chapter 7 on Board Committees) with some companies creating committees not then in place:

“In 2002, Benpres adopted a Manual of Corporate Governance which was made mandatory by the SEC. Pursuant to the Manual of Corporate Governance, the following were undertaken:

- two (2) independent directors were elected;
- an Audit Committee was created;
- a Nomination Committee was created;
- a Compensation and Remunerations Committee was created; and
- a Code of Corporate Conduct was adopted.” – Benpres

For one company in particular, behaviour of employees rather than operational issues is reflected in their manual:

“The manual of corporate governance is on how to behave, to do things such as not to cheat customers.” – private sector 2

The corporate governance manual has altered and formalised the structure of boards in the country.

5.3.3 Disclosure

Besides periodic financial statements, assessing the disclosure of material information that may unduly become a business risk for the company is part of the SEC's oversight:

“It is not enough to have disclosures in periodic reports for selected companies. When the SEC feels they require to submit more certification [for directorships], directors do so under oath so they are [reluctant to falsify their qualifications] before they exclude certain allowances...

Disclosure is part of the corporate governance tenet of transparency:

“So how do we enforce corporate governance? Through disclosures. Transparency is a sign of good corporate governance. Here we have our own disclosure requirements. The PSE has their own within minutes. Here with the SEC it’s within 5 days. However, most companies, when they submit information to the PSE, they also cc the SEC. But it is not sufficient. You have to personally file. It needs to be disclosed as part of disclosure practices...we encourage companies to disclose timely information [if they don’t] there is a scale of penalties.” – SEC I

For one company at least, a disclosure-ready culture to comply with regulations has become operationalised:

“[We disclose] on a regular basis with media releases. This is also in accordance with the SEC. We need to submit our accounts to the SEC, the annual report lodged with the SEC, copies to the media and all to the shareholders. There is not a lot of contact with PSE much. We make regular disclosures.” – private sector 1

However, compliance with the new culture that emphasises disclosure means reams of paperwork are generated. This is not an easy task for the SEC nor for the companies it regulates:

“We analyse annual reports, quarterly reports, information statements, beneficial ownership reports. The most difficult would be annual reports. They are reviewed preferentially to information sheets. We require distribution of these sheets 15 days before the annual general meeting.” – SEC I

“We wanted the SEC to revisit the evaluation form in public companies. The ICD’s helping develop a more practical evaluation system. The SEC has 99 items for the peer evaluation form with a coverage of 13 pages. It is too much, too many, too petty.” – private sector 2

For one small company interviewee, the corporate governance code is seen through the

rubric of compliance and its associated costs. To my interviewee, corporate governance is burdensome to small businesses like him:

“Why did I say corporate governance is a pain in the ass on the phone? In the Philippines we’re being made to do this, to write manuals on corporate governance, try to fulfil what we’re talking about. We also have to report that the manual corporate governance is up to date. They make a lot of fuss about it. So it’s a pain in the neck doing all these things. A large organisation would have times for all of this. There’s no problem for them, they can tell one department to do this for them, tell them what to do. Here, our company is small. It only has 20 employees. All of my employees are doing things, doing their jobs during the day. Attending to corporate governance is a pain in the neck.” – small company

Creating a more transparent business environment has brought its challenges: the regulated must adjust to the new requirements and equally the SEC has to be ready for the information generated. Corporate governance as compliance has emphasised disclosure of information at its heart. Creating a culture where there is “a regime of disclosure” in a largely insider business environment is an ongoing process.

While ensuring companies have incorporated corporate governance reforms is now a responsibility for the regulator, the main activity of SEC remains its monitoring and supervisory role. The SEC is expected intervene in the market when waves of Ponzi-like schemes come and go, and keeping a watchful eye on the PSE, the capital market regulator. The next sections look at these responsibilities in detail.

5.3.4 Monitoring Companies: The Pre-Need Industry

During my fieldwork, some interviewees questioned the effectiveness of the regulator and the problems of the pre-need industry. The pre-need industry is under the regulatory oversight of the SEC although its products are arguably close to insurance:

“a pre-need company is a SEC registered corporation which sells preneed plans that are essentially contracts or agreements that provide for the performance of future services, payment of monetary considerations at the time of actual need or agreed maturity.” (Espinilla 2006: 138-139)

Over the course of one interview, one of my SEC interviewees exclaimed:

“Thank God the bomb over pre-need didn’t go off.” – SEC II

Popular pre-need products relate to educational or college plans. As befitting a culture that prizes education and the rewards that come with being educated, such plans were popular with overseas Filipino workers (OFWs):

“What has become big which are neither listed nor registered issuers cover mostly schools, universities and hospitals. Hospitals would issue their shares to medical practitioners. Private schools would issue shares to employees, teachers and students. Pre-need companies issue educational plans, memorial plans and they have become problematic. These pre need companies sell educational plans. After a person or family has bought these plans they expect to have the money from these plans when the time comes to fund high school or college education. You know how Filipinos are. They would sell their *carabao* or the farm to fund education. Some have become OFWs so they can send their kids to school. They [OFWs] purchase pre-need plans, then come college or school time the money’s not there.” – SEC I

Some operators saw the money flowing into the industry as an opportunity to exploit these aspirations and the pre-need industry nearly collapsed (Rimando 2008). The role of the SEC came under scrutiny and there were questions whether the plans were insurance products and therefore under the oversight of the Insurance Commission:

“[The modus operandi of] the pre-need companies were “give me X amount for young child’s education so when it comes to college, I’ll pay for the college tuition.” The Department of Education removed the [ceiling] controls on tuition fees. [The companies] continued to sell plans [and it became a] pyramid scheme. They were not [seen as] insurance products and were only regulated by the SEC. [So you have a] financial institution selling a promise but it was not regulated by the Insurance Commission. [These companies were] selling securities to poor Filipino families. There’s something defective with the law to begin with when [pre-need companies] are not under the Insurance Commission.” – private sector

1

Another academic interviewee pinpointed the problems of the industry to the new financial reporting requirements which adhered to international financial standards that

changed the profit valuation of the companies. For many of his colleagues who participated in the plans, the industry's near-collapse was personal:

“The BSP specifically has introduced structural, better guidelines in terms of disclosures. This is why the College Assurance Plan (CAP) suddenly became unprofitable and its P3B net worth becoming negative by at least P1B due to the BSP requirements of international accounting standards. The valuation became different. It was due to the constant thing to the change on the way we returned and the change on financial statements. [We are] moving towards the IAS – which turned the direct product from a profit into a loss. It's all about proving [the companies] are able to pay for college [but not being] able to anticipate the increase of tuition fees. [They say it is] not responsible to forecast [that increase] as it's a very good plan.” – academic

Global convergence of financial reporting has its drawbacks. Issues over valuation soon saw the industry and regulator on opposing sides of the debate with the regulator trying to regulate the industry so it could meet international standards, while the private sector found itself in the red almost overnight:

“They blame each other; CAP blames the SEC for being unreasonable to adjust the way of reporting. The SEC says it's just doing their job, this is the right thing. By changing the way reporting is done you turn the P1B profit into a loss. With all monies made, it's a set of really to trying to be on par with the rest of the world. Why are they (SEC) doing this? Whether CAP failed because of corporate governance but is government about this? Raising awareness? Has the government done something differently? They've changed the rules so the rules are friendlier to corporate governance.” - academic

For the SEC, recognising the relative merits of the product and distinguishing it from other insurance products remain at the core issue over the near-collapse of the industry. The pre-need educational plans have a predictable maturity, akin to a term deposit:

“In the pre-need industry they were using an insurance calculation with the exception of the life plan - that's why you buy an insurance industry product. In education there is no catastrophic event. You know exactly when you'll be [withdrawing the money]. You were using an actuarial valuation. It was a front

load mark-to-market plan. [The problems arise if] 15 years down the line [the consumer] couldn't claim. That was all in the use of regulation." – SEC II

Thus for the SEC, enforcing international accounting standards has had unintended consequences for one industry and the millions of lives affected by this one sector in the country.

5.3.5 Oversight of PSE

The SEC has the core supervisory role over the capital market regulator, the PSE, and other entities that have demutualised:

"We also cover Manulife and Sunlife which listed on the PSE because they demutualised so Filipino shareholders do not have to dispose their shares and trade in an overseas market like Canada. They can instead sell their shares on the PSE. The trend is for Asian countries to promote cross-border trading." – SEC I

Unlike the two Canadian insurance companies above, the PSE demutualised to decentralise the power of the stockbrokers over the exchange. The PSE has undergone its own set of corporate governance reforms (as the section on the PSE in this chapter shows). Like other stock exchanges around the world which have demutualised, an inherent or perceived conflict of interest exists when the capital market regulator is listed on its own exchange³⁹:

"...[the PSE is] a self-regulatory organisation [and the onus is on them to act] especially over what you think is right. Don't cross [that line or perception] or you [will get hit] with the kitchen sink." – SEC II

The Latin saying *quis custodiet ipsos custodes* (or who guards the guardians) characterises the relationship between the SEC and PSE. Corporate governance reforms within the PSE are a work in progress and the SEC has oversight that these reforms are taking place. As the entity in question is the capital market regulator, the approach has a more sensitive turn. For the SEC, their oversight includes ensuring the once broker-dominated exchange has progressively reduced its ownership stake in the PSE. This can

³⁹ The effects of demutualization on the corporate governance of stock exchanges have been discussed by Hart & Moore (1996), Steil (2002) and OECD (2009b).

be seen through the enforcement of minimum requirements for outside director representation on the board of the PSE.

The make-up of the PSE board is an important signal to the market that the exchange is becoming more independent from its broker origins. At the ICD Annual Dinner, the Chair of the PSE stated:

“Eight out of 15 members of the PSE board of directors are non brokers. Three of the eight are independent directors. The Chair and President are non-brokers. 47% of ownership still with brokers but moves to get it down to 20%.” – Vitug, PSE Chair.

These reforms continue to be a struggle and opposed by some brokers who are protective of the status quo. The issue of board seats is reflective of the PSE’s ownership composition. In 2007, the SEC penalised the PSE for non-compliance with the reforms that required the broker ownership composition be reduced to 20%. The SEC penalties are evidence of the PSE’s internal battles. Noncompliance by owners, rather than the lack of enforcement by managers is the issue. (Rubio 2007b)

For the SEC, ensuring a well-governed PSE is a matter of investor confidence, market integrity and public credibility. For the PSE, the professional managers of the exchange are hampered by the wishes of the owners who are reluctant to have any further reform that dilutes their power. Who owns, controls.

5.3.6 Resource Issues affecting Monitoring

The ability of the SEC to regulate and to monitor the companies it oversees was an issue with some of my interviewees. Like most other government bodies, the resource deficiencies are well-known. Constrained internally and pressured externally, all regulatory institutions such as the SEC need to work within these limitations. As my ICD interviewee explained, the availability of technical and human resources impact the ability of the regulator to regulate:

“We deal with heads of institutions. They fully subscribe to corporate governance principles. But there are issues:

- there is no capacity or technical know how

- there are staffing and resource issues which are challenging for them
- the SEC is committed to governance reform but they need help from us

“The intentions are genuine and they are there. There are certain interferences from above (government/politics) that muddle the issues. The pressures are exerted. These pressures with the lack of resources and lack of capacity – the good intentions are not enough. Where would the good intentions bring me? Against this is the SEC deals with a heterogeneous group of corporations with complexities on governance issues. For example, what to do with holdings and manufactures? The commitment is the same as the BSP but the BSP gets things done.” - ICD

The reorganisation of the SEC in the early years of the 2000s saw a reduction in the personnel. The resource issue within the SEC comes down to the matter of personnel – both in terms of quantity and quality.

“We are struggling with monitoring the information sheets and audited financial statements. A department of 30 people is in charge of monitoring listed companies, registered issuers, and financing companies of which there are around 800. We do have resource issues. There always not enough staff.” -SEC I

There is an overwhelming amount of information that is required to be processed and analysed by a small team:

“We have a core of 13 people – 5 CPAs and 8 people who regulate closely the financial reports. There are 13 people covering 500 corporate entities. To solve the resource issue we have asked HR to increase the number of people. In 2000, when the SEC got reorganised, there were plans for not too many people as there will be automation soon in the SEC. [7 years later, we are still waiting]. We hoped that ordinary corporations could file their reports via online. It should have been in place by April 15 but the SEC wasn’t ready. Hopefully, this will be done next year. Our capability is not sufficient so [companies] are still filing with us hard copies.” – SEC I

As one interviewee wryly pointed out:

“The SEC does not have much people monitoring compliance.” – private sector 1

A strong private sector requires a strong regulator. The resource weakness of the SEC

undermines its effectiveness and ability to enforce existing regulations.

5.3.6.1 Coordinating the IT infrastructure

When I first entered the SEC, I saw queues of people waiting to file their papers. The delays in more electronic ways of filing company information and automating are a whole of government issue. This is the IT infrastructure issue that confronts the SEC and the rest of government machinery. Different arms of the government bureaucracy have their own databases and linking them up to have a more streamlined and centralised form of connectivity is a challenge:

“There are some 500,000 companies. We need to have the databases linked such as having a single TIN (tax information number). It is not taking the reach off point yet. A central hub database is not just an information exercise. The hub needs to be able to talk to each other.” – SEC II

To aid enforcement, some suggested there be technological harmonisation of company databases and information so this would provide a central point for all regulators to ensure the same information was being filed with them. This would cut duplication and administration barriers in the process:

“With the SEC, you could have a database of companies, financial statements. But we’re talking to deaf ears. For PSE listed companies you could do that with the SEC and reduce some of the bureaucracy. The people in agencies BSP, SEC, IC can think about [harmonisation].” – private sector 1

Technology, while an attractive option is no silver bullet. Problems of security over personal records and abuse of confidentiality are major stumbling blocks. The possibility of crime syndicates accessing and manipulating the information was brought up by one interviewee:

“For example, [you could] introduce technology across industries. In Australia, you have the tax file number – here there is no utilisation of tax file number, no utilisation of a social security number. They’ll not consent as these different institutions can give the above numbers to the banking industry. It could be done but it is hard to sell. The real reason may be to hide. If you had a common system, how do you keep it secure? There are syndicates that go in there. Bring in someone in there, retrieve and distribute the information.” – private sector 2

The computer languages of the databases of the different government bureaucracies are also different. This leads to frustration but is symptomatic of the unwillingness of agencies to coordinate and cooperate:

“[At the] bidding stage the computer languages are different. Sun/Solaris – who else is using Solaris these days? Our [computer] language is not the language of BIR, Customs. If we put up a hub it may become the Tower of Babel. Maybe when you can cross- check and link it with the Department of Trade and Industry and tell us the company with the business name, registration of names [I asked him about trademark and copyright violations]...There is the CICT. It is the Cabinet Office in Charge of Technology. There is a strong reformer at GSIS [discussion on how Winston Garcia managed to computerise the systems at GSIS]. But it’s just information and retrieval. It’s interactive here. We need one that stores and retrieves...[however] we have bit off more than we can chew. We have a computer system that is a Ferrari on a *barangay* (rural) road.” – SEC II

My interviewee’s last comment of having a top of the range computer system but not having the basic infrastructure (e.g. such as reliable power supply) to run it reflects the simultaneous aspirations and disappointments of the task in improving the country.

5.3.6.2 Attracting the Best and Brightest

Aside from databases that need to be networked, are adequate and practical, another interviewee pointed out the Philippine public service needs to attract the best and brightest. Excluding the BSP’s fiscal independence, the remuneration in government is a strong deterrent in attracting *la crème de la crème*. The SEC’s situation is no exception:

“[The SEC is] constrained by resources. Specifically in the government sector [a main constraint is] the ability to retain and attract people. The regulator has to understand everything that is happening in industry. The compensation is a small fraction compared to the private sector. The problem recurs throughout the bureaucracy.” – academic

Enthusiasm for selfless public service can only be sustained for a limited amount of time before reasons of pragmatism and materialism rule out such idealism:

“At the SEC, joining the government is a sacrifice to some professionals. To induce them to become government officials, there are a few. Lawyers join the

SEC but you don't find the bright lawyers joining government. There is a strong pull of getting material things. The pay scale in government is below and only a few would join out of passion and commitment. The challenge for the SEC is to [attract staff from other] organisations. During Chairman Bautista's time, she initiated to increase the pay scales but in general, in order to get good professionals the [SEC] should provide better pay scales." – private sector

In a land of poverty, a more satisfying career in a functional private sector than a dysfunctional private sector is no choice at all. I further discussed with this interviewee the differences in resources and appearance between the BSP and SEC. At one point he mentioned the dreams of a centralised government city along the lines of Washington DC or Canberra in a post-independent Philippines that has long since vanished:

"During Filipino independence, there were vast tracts of land in Quezon City that was destined for all government institutions. [Progressively, the lands] have been sold out, there are some few agencies but the original vision has totally disappeared" – private sector

Nevertheless, the slow move towards professionalisation in the regulator is an encouraging sign:

"One of the things that happened was the SEC was moving in the direction of professionalisation and the PSE is moving in that direction. [Having] more [professionals] strengthens the state. They strengthen the autonomy of the state and they fill the professional base of the SEC and PSE. You need to do that." – academic

To attract quality public sector candidates requires remuneration commensurate with their responsibilities; incentives (including intangibles such as the prestigious nature of the post) which would deter any temptation to use positions for personal gain; and the recognition that serving the country is not necessarily a sacrifice but a worthwhile service.

5.3.7 Private Sector Opinion

Despite the financial shenanigans the SEC has to deal with and the rocky implementation of the Corporate Governance Code, overall most private sector

interviewees were positive in their assessment of the agency. Given the resource constraints it has, some interviewees held the SEC in utmost esteem:

“The SEC is a very effective corporation. I like the SEC. It is one government corporation that is doing its job very seriously. It is run very well, it is very good.”

– private sector 1

“The SEC is one of the best run government agencies, they are very professional”

– private sector 2

“[Are] the SEC and the PSE effective? I guess so. Certainly the SEC is one of the better GOCCs [government-owned and controlled corporations] but it’s still operating as a government agency.” – private sector 3

While others, who were not as glowingly positive about the SEC, nevertheless acknowledged that there was some improvement:

“The SEC has improved a lot.” – lobby group

“The SEC is much more efficient now than before..If only regulators can be promoters so implementation can be done so we can have a private sector. But are they willing to let go? [But the attitude is] what’s in it for me?” –private sector

4

One interviewee pointed out the SEC’s improvement was a reflection of the external pressures it has faced – that a strong private sector does require a strong regulator:

“[The SEC’s] improved for example with having to change to being stricter with the [accounting] rules. [They’re] changing per se, [and the SEC’s action over] CAP [which was] hit by it. [We] have higher expectations and begging ourselves not to be last if the goal is not to be last in terms of corruption not just in government but in corporate corruption as well. The Scandinavians are more ethical.” – academic

For interviewees who were vehement in their criticism of the SEC, the agency’s monitoring oversight was again pinpointed as its weakness. One company had an issue with trademark violations and this was linked to the duplication of responsibilities in government and the country’s weak protection of intellectual property rights:

“Here in the Philippines, we are a well-established corporation. The big issue for us is our Blue Cross Logo that we have. It is registered under the Department of Trade and Industry (DTI) and the SEC. That’s two agencies with the SEC for the trademark. We guard our Blue Cross trademark jealously. You can now check online and see how many people use Blue Cross. There are 25 organisations that have Blue Cross as their trademark on the SEC database. You’re allowed to do that as long as it’s not in a related industry.

“...There are quite a few trademarks of Blue Crosses in the industry that has been registered. The registration of our trademark was all prior to them. So when is the monitoring of the trademark done? How does the SEC and the DTI put into place the monitoring of this? Is it system driven? You do a DTI search and you get all the names of companies that use our trademark. Why do you allow registration in a related industry but tell us that you shouldn’t?” – Blue Cross

In 2007, a case of conflict between the majority and minority owners of a listed company played out in the public press.

“PRCI is a family corporation masquerading as a publicly listed company. We have a Manual of Corporate Governance which the SEC requires of all publicly listed companies after the Enron scandal in the States, but it is honoured more in the breach than its observance. There is no real corporate governance. It’s all lip service. That’s why we believe the SEC should come up with measures to strictly monitor and enforce the compliance of publicly listed companies with the Code of Corporate Governance. Otherwise, it’s not even worth the paper it’s written on and we might as well do away with it.”- Arnaldo (2007)

This case exposed – again - the weak enforcement of corporate governance regulations, but this time in the area of protecting the rights of minority shareholders. I did contact the company in question, PRCI, if they wished to discuss their corporate governance practices but my request went unanswered.

5.3.8 Future of Corporate Governance Reforms

For the SEC, as the main regulator of corporations, it has a challenging task ahead in ensuring corporate governance reforms are implemented in substance:

“For the future of the SEC, it would be the same but fully implementing the practice of good corporate governance. It may be difficult but we are committed to make sure listed companies get funding from the public and they follow the principles and practice of good corporate governance.” – SEC I

Additionally, the reputation of the country’s legal system means another way to settle commercial disputes could be in the offing:

“[I would like to see the SEC have] quasi-judicial powers to deal with intra-corporate disputes instead of giving it to the normal courts. It’s an argument of expertise. The courts can’t have that aspect of trust. In corporate courts the judges come as fine, fiscally-aware former clerks. The orientation [of knowledge on commercial matters] is still at a minimum and there is not much awareness that’s why there are a lot of revoked corporations. If you don’t file in the next 5 years, the [companies] get revoked. The orientation is not there.” – SEC II

Overall, the SEC sees the future of corporate governance as being more formalised or codified in law. In an optimistic best-case scenario, corporate governance practice will be part and parcel of doing business in the Philippines:

“We still have a long way to go but we are trying our best to comply. In 10, 15 years (and that would be an optimistic time line) we will able to make corporate governance a way of life for all corporations.” – SEC I

The resource constraints, the multivaried responsibilities of the SEC and the country’s developing economy environment can only ameliorate the agency’s supervisory duties:

“It will take a long time to do what needs to be done properly. How do you implement corporate governance in a country where the majority of people work in an informal environment is substantially cash based? How do you introduce corporate governance? How do you get small family-owned corporations to even consider these issues? It is also a substantially rural-based economy. In the provinces it’s all cash. How do you get the SEC to issues operational reports? It’s almost impossible to regulate and monitor corporations. Browsing through the SEC, two-thirds of corporations don’t renew themselves. It would take sheer bureaucracy to do that.” – private sector 5

In this sense, corporate governance reforms in the country must be considered in context. For the SEC, corporate governance remains a work in progress. As the real economy grows, there will be increased pressures placed on the SEC to substantially improve its regulatory capacity.

5.4 Philippine Stock Exchange

The Philippine Stock Exchange (PSE) is the capital market regulator in the country and is supervised by the SEC. (PSE 2009b) Out of all four regulators in this chapter, only the PSE is a non-governmental organisation and is designated a self-regulatory organisation (SRO). The PSE has oversight of nearly 250 listed companies (WFE 2009a: 29). The PSE is a member of the World Federation of Exchanges which is an association comprising of 53 regulated exchanges globally (WFE 2009b).

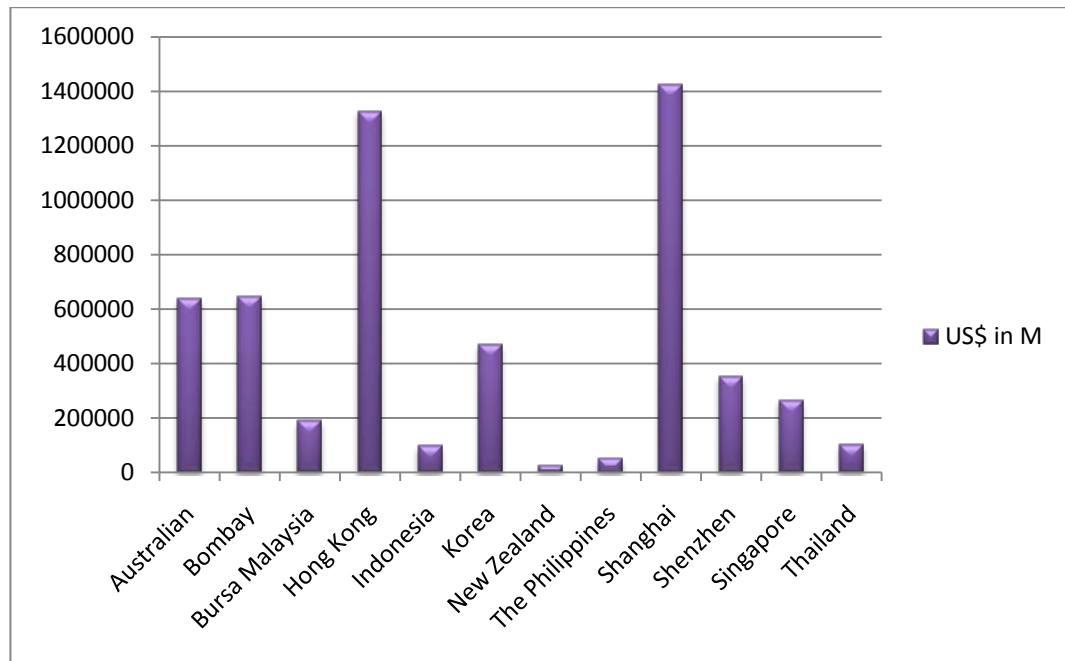
5.4.1 History

The PSE is the result of the amalgamation between two rival bourses: the Manila Stock Exchange and the Makati Stock Exchange. The Manila exchange is located in Ortigas, while the Makati exchange is located in the Makati CBD.

During my visit to the Manila exchange, a memory plaque stated the Manila exchange was established during the American colonial rule on the 8 August 1927. The founding members were five Americans: WPG Elliott, Erick W. Little, Gordon W. Mackay, John J. Russell and Frank W. Wakefield. The Makati Stock Exchange was established in 1963. In 1992, both bourses were forcibly unified and in 1998 it became a self-regulatory organisation (SRO). In 2001, the PSE was demutualised with help and advice from AusAid and the Australian Stock Exchange (ASX).

Historically, the PSE is one of the oldest exchanges in Asia. However, perhaps as a reflection of the country's stunted economic development, the PSE is also one of the region's smallest exchange by market capitalisation as the next figure shows:

Figure 24: Domestic Market Capitalisation of Asia-Pacific Stock Exchanges (WFE 2009c: 84)



In 2008, the PSE's domestic market capitalisation was valued at US\$52, 030M. In comparison, the booming stock exchanges of Shanghai (\$1,425,354M) and Hong Kong (\$1,328,768M) reflect the booming economic growth of China.

The various organisational upheavals in the history of the exchange have not been without its difficulties. At the time of writing, the legacy effects of the amalgamation of the bourse still lingers. The demutualisation of the exchange saw the brokers' control and ownership over the exchange reluctantly diluted with non-owner managers professionally running the PSE. The following sections look at pertinent organisational issues such as its trading floors, trading hours and the old boys' club. These issues represent the field of contestation between the PSE's owners and its professional managers.

5.4.2 Trading Floors

A traditional stock exchange has a trading floor where brokers buy and sell shares of listed companies. Some exchanges such as the ASX are now fully electronic so the trading floor does not exist in reality anymore. During my fieldwork, it was quite an incredulous moment to be informed that in a resource-starved country, there was adequate provision for one of the smallest exchanges in Asia to have two world-class

trading floors that only run three hours per day. The following observation notes I made comparing and contrasting the two floors bear this surprise:

“This bit of the interview surprised me. I didn’t realise that the PSE only opened in the morning for trading i.e. three hours. I was surprised and told [my PSE interviewee] that it might be a competitive disadvantage compared to other exchanges in the region as a potential foreign investor may not invest because there is only a brief trading window. I suggested that the PSE ought to open from say 10-4 or 10-3 as the business day in Manila is all day long. [My interviewee said] they experimented with longer hours in 2003 but the trading volume remained the same.” – Manila Stock Exchange observation notes

“[My interviewee] showed me the Makati Stock Exchange which is a full trading floor like the Manila-based one where the PSE was headquartered. This prompted me to text the PSE about two trading floors at opposite ends of the city being a waste of resources since they only trade for 3 hours. Makati is as big or as glamorous as the Ortigas one.” – Makati Stock Exchange observation notes

While technically the bourses have united, physically they have not. This is an important distinction. Indeed two of my interviewees pointed out previous cases of “inter-bourse arbitrage” where an entrepreneurial arbitrageur could sell a company’s share at a higher price at one exchange and buy it low at another:

“Before there was arbitrage [between the two exchanges]. Hopefully when we go to Fort Bonifacio [that will unite the exchanges]” – SEC

“[There were] sensitivities [in amalgamation]. [They] wanted to reform the Makati Stock Exchange to make it as the only one and put up the PSE there. For the PSE now it’s all linked, previously there was inter-bourse arbitrage (*chupitero*). [It’s the] aspect of exchanges. Now there is also computerisation. There were the old guards who were against computerisation as it’s a small bourse and they provide a personalised service.” – private sector 1

The main reason behind the reluctance to unify is largely cultural. The two exchanges represent two dominant ethnic groups that dominate the bourses: the Filipino Chinese brokers of the Manila exchange, and the Filipino-Spanish brokers of the Makati exchange:

“There is the pride of having a trading floor in Makati. In Manila it was the Chinese group with the formation of the Chinese trading floor in Ortigas and the Spanish mestizos in Makati on the other side.” – SEC

At the time of writing, the unified exchange has yet to materialise physically in its new location in Fort Bonifacio:

“The Fort Bonifacio unified exchange [has been] delayed to 2011.” – PSE

Locational issues aside, the PSE makes the point of ensuring the technical aspects have been covered and that these two trading floors do not lend themselves to such arbitrage activities anymore (PSE 2009b).

5.4.3 Trading Hours

“The PSE is open from 9.00-12.15. From 9.00-9.30 – the PSE opens. From 9.30-12.00 – the market is open. From 12.00-12.15 – this is the market run.” – interview notes

Similarly, the idea of having three hours for a trading day was a rude shock. Both trading floors are open for three hours in the morning only. Being informed of this, I did make the point of asking my subsequent interviewees about the tiny window of trading on the PSE. Coming from Australia where the trading day reflected the working hours of the general populace, the idea of three hours for a trading day seemed unusual to me. The ASX’s trading day was 6 hours long and the trading floor had long been computerised although a computerised board for the public exists in Sydney’s Martin Place. (ASX 2009)

Still, in my naivety, I did not expect that the PSE would support and have two trading floors yet would trade for only three hours a day. From a resource-efficiency point of view it didn’t stack up. Everywhere in Manila I was constantly reminded by the lack or limited amount of resources an organisation had to deal with. Yet two trading floors for three hours per day seemed sheer extravagance to me. Countering this argument, as some subsequently pointed out, the PSE is a small exchange and the market activity during the three hours is intense. A previous experiment to extend the trading hours was a failure and there was not much enthusiasm for it to be repeated.

Interviewees who were supportive of an increase in the trading hours pointed out reasons of increased volume, increased market activity and alignment with the rest of the region:

“We have had 10 new listings this year. We are undergoing a listing on the IPO this year. When we have enough business, then we’ll have the afternoon trading. There is still a lot of upside in [extending trading hours]. Currently the market trades USD100M per day. That’s decent volume already. Back in 2000, a couple of trading days there had only a trading volume of USD6M. If we open all hours then the trading volume could go up to USD200M a day. In an open market the year to date is USD90-100M a day. This year’s been quite good. When you have more IPOs you’d [have another incentive] to open up for trading. The last 12 months has been the busiest for IPOs with follow-on offerings, new shares and old ones together. It has not been this active since the [East Asian] crisis.” – broker 1

“If there is an increased trading hours there would be more depth and width. The Philippine market is small so they can only hold so much trading interest.” – private sector 1

“The entrepreneurs and capital markets ought to play a role. If the PSE opened the trading hours that would allow development so there would be a lot more companies to do IPOs and improve the reporting,” – private sector 2

“When they increased the trading hours – we tried it for a month in 1999 – the market was trying to recover then [after the crisis]. The other stock exchanges – it’s the only stock exchange I know in the region that is only trading for half a day. The Jakarta Stock Exchange is open all day.” - broker 2

This last comment prompted me to do a quick comparison of other trading hours of the exchanges in the region. Below is the table I came up with and which I subsequently presented at the Ayala Corporate Governance Forum in August 2007:

Table 24: Asia-Pacific Stock Exchanges' General Share Trading Hours (Source: WFE 2009d)

Exchange	AM (Trading Hours)		PM (Trading Hours)
Australia	1000-1600 all day		
China (Shanghai & Shenzhen)	0930-1130	Break	1300-1500
Hong Kong	1000-1230	Break	1430-1600
Bombay	0955-1530 all day		
Indonesia	0930-1200	Break	1330-1600
Korea	0900-1500 all day		
New Zealand	1000-1645 all day		
Malaysia	0900-1230	Break	1430-1700
Philippines	0900-1210	Morning trading only	
Singapore	0830-1706 all day		
Thailand	1000-1230	Break	1430-1630

Out of 11 countries in the region, the PSE remains the only exchange that trades in the morning only. Interviewees who were ambivalent about extending the trading hours cited the lack of demand and the exchange's relatively low volume and small size.

"If there's a demand, they'll extend trading hours." – investment banker

"The PSE in the Philippines is quite insignificant. For a long period of time the PSE has not been on the radar for foreign investors. If the trend continues economically there'd be pressure to extend trading hours as a function of the volume, with the two stock exchanges. [Extending the trading hours] would not be an economic decision [for the brokers but more a political decision]." – private sector 3

"The PSE is a small exchange. It does not need many hours or market capitalisation volume activity. It is as small as Colombo, Sri Lanka. We are one of the oldest stock exchanges [in the region] and we have been left behind by our neighbours. It is a loss of our comparative and competitive advantage. There is a cost consideration for the exchange. It would carry costs [if they extend the hours]. Members would not feel justified by the incremental value within those hours. They would see more activity but could be very slow. They would lose more interest or create queries. Essentially, they would be spending money before receiving a buck. If it led to better evaluation of companies, they would

appreciate more the longer hours of the trading day. This is on the pros and cons of extending trading hours.” – private sector 4

One could pose the chicken-egg problem: do the limited trading hours place a ceiling on the volume or growth of the PSE or is it due to the lack of depth in the PSE that discourages any extension to the trading hours? This conundrum was never fully investigated during my stay there but in perhaps another foray into the history of stock exchanges around the world, some pattern may be discernible on the causality of the relationship.

5.4.3.1 Impact of Trading Hours on Companies

While the benefits of longer hours are yet to be appreciated, the limited trading hours does impact on the timing of company announcements. Very good news or very bad news may be announced by the company close to the end of the trading day and it would take a cycle of 21 hours for this news to be digested and traded by the market when the bourse re-opens. Such a situation makes the PSE vulnerable for activities relating to market manipulation.

“[We announce to the] PSE with respect to the cash dividend declaration within 10 minutes after [the board’s] approval. It’s more of a rule in theory than in practice. We have to wait for the board of directors to adjourn. If it’s close to the close of trading we would disturb the trading at 1230pm. [The PSE did] try to [trade] for the whole day [but it is now] trading only in the morning.” – private sector 1

The volatility of the three hours imposes limitations on companies and perhaps contributes to the widely-held perception of insider trading within the exchange:

“The PSE is very volatile. We had a low share price a few months ago and it now jumped to high. It is a bit all over the place. There is a factor of various stock exchanges in Asia, the volume in trading generates interest e.g. Chinese model, people can’t bet so they go to the stock exchange. This is something that happens in this part of the world. The low volumes of trading here in the Philippines are a reflection on why you do need to have bigger trading hours on the exchange.” – listed (2)

Limited trading hours on the PSE have an effect on companies making timely disclosure to the market.

5.4.3.2 Importance of Golf

Aside from market capitalisation size, one broker pointed out a list of self-serving reasons why – in all seriousness – that extending the trading hours would be highly inconvenient for the brokers of the PSE:

“There are now talks about the possibility of doing business in the afternoon. Many wouldn’t like it. It would interfere with their golf, lunches. In the afternoon, it was 930-12, 12-1 then 1-3.30 [The extended trading hours] really interrupted their lunch, and changed their lives. Many of our members wouldn’t like it. On this particular question I could go either way. It is not important, money earned in the afternoon session was so small it might not be worthwhile, they’re studying it now. There is no real desire from brokers to have an afternoon session. Many brokers value more their time than money. If we were certain we’ll double the amount of money we’re making now, it would take a lot of staff, a reconfiguration. We go home at 530-7pm. At 4pm closing, you would go home at 8-9pm at night. You would need new people because you can’t do it every night. There is a serious configuration required. A P10B trading volume every single day would require a method of cooperation. [We would need to hire] additional staff to cope with the whole thing. It can be done. Except I’m not joking when I say it’d inconvenience the brokers. It’s just not worthwhile even if we can make twice as much.” - broker

This insight into the attitudes of some brokers gives the impression of an insider culture with a high sense of entitlement towards the functioning of the exchange. It struck at the core of what the purpose of a stock exchange is – is it to serve the brokers or to contribute to the country’s capital market development - or both?

The identity crisis in the ownership of the PSE reflects the clash between the old ways and the pressures of the new economic reality. Intriguingly enough, a paper written by Hart and Moore compared the membership of a stock exchange to a golf club - the love of golf and being a stockbroker seems to be complementary. The golfing analogy in Hart & Moore’s paper extends to improving the infrastructure including bunkers, greens, clubhouses and various accoutrements:

“The parallel with an exchange should be reasonably clear. The assets of the golf club (the course and clubhouse) correspond to the assets of the exchange. The playing members correspond, say, to large financial institutions; the social members correspond, say, to smaller brokers. In money terms, the large financial institutions have much more at stake in the exchange than have the smaller brokers.” -Hart & Moore (1996: 58)

The players and the social members of the club are reflective of the culture divide between the old and the new brokers. Reforms to break down the barriers to ‘golf club’ entry were received unenthusiastically by the old time members (see later in this section on The Old Boys Club’).

5.4.4 Demutualisation, Professionalisation and Ownership Issues

The demutualisation of the exchange saw the mandatory decrease in ownership by the brokers of exchange who wielded absolute control and the professionalisation of management in the organisation. Demutualisation required external influence to enforce this particular reform and change. In particular advice and help from the ASX and AusAID were sought to push the PSE along this particular road. This reflects again the external influence and coercive isomorphism of institutional development in the country:

“Demutualization is part of the PSE’s integral efforts to strengthen professionalism in its business operations, maximize transparency, reinforce competitive position globally, and optimize financial performance. The conversion marked the pinnacle of the year-long efforts to comply with the deadline set by law and seemingly unending months of conferring with the Australian Stock Exchange (ASX) consultants who extended technical assistance in the study and development of the appropriate demutualization framework for the PSE. The demutualization study conducted by the ASX consultants and financed by the Australian government through the Philippines-Australia Governance Facility (PAGF) – Australian Agency for International Development (AusAID) covered business model options, corporate governance model, membership and trading participants rules, operating and business guidelines,

market regulation policies, financial issues, and organisational structure and manpower requirements.” (PSE 2009c)

Furthermore, reducing the majority ownership of brokers is enshrined in law. According to the Securities Regulation Code, Republic Act 8799, section 33(c):

“Chapter IX Exchanges and Other Securities: Trading Markets
s 33 (c) where the exchange is organised as a stock corporation:

“that no person may beneficially own or control, directly or indirectly, more than 5% of the voting rights of the exchange and no industry or business group may beneficially own or control, directly or indirectly more than 20% of the voting rights of the exchanges. Provided however, that the commission may adopt rules, regulations or issue an order, upon application, exempt an applicant from this prohibition where it finds that such ownership and control will not negative impact on the exchanges’ ability to effectively operate in the public interest.”

As the ownership control of most Philippine corporations consists of major blocks in excess of 50%, the 20% limit for a block ownership of the exchange is yet to materialise, hence there were penalties imposed by the SEC on the exchange over its inability to meet this ownership criteria:

“The PSE is regulated by the SEC. Most of the shareholders are still the brokers at less than 48%. Under the law, not one group, individual or business entity should own more than 5% of the PSE. And not one industry can own more than 20%. This legal requirement is, in effect, to ensure that the PSE is an open exchange. The brokers group, though, still remain big owners.” -PSE

The reduction in ownership has seen some improvements:

“[The 20% requirement] has introduced professionalisation in the stock market.” - SEC

“As you can determine from the comment about golf games, the brokers have had a sense of entitlement for far too long and have been dictating how things go for such a long time, that they forget why the exchange demutualised in the first place, to curb their influence and to manage the exchange more professionally.” - regulator

“The PSE corporate governance practices have improved with the election and rules of demutualisation by virtue of the requirement of having more than 50% coming from non-brokers. It gives more confidence [in the PSE]. More trust.” – business advocate group

However, the reduction in ownership has yet to meet its legislative requirements. The battle for the control of the PSE is ongoing. In January 2010, the top professional manager of the PSE, Francis Lim, departed after five years as President and CEO. (Dela Peña 2010) Being a professional manager in the PSE is no mean feat as invariably an independent manager is caught in the web of competing interests between the SEC, the owners and the market participants.

5.4.5 PSE Corporate Governance Guidelines

In terms of corporate governance reform, the SEC Code of Corporate Governance 2002 takes precedence and is applicable to listed companies. However, the PSE has issued Guidelines for Corporate Governance for listed companies in 2009. Similar to other corporate governance reforms in the country, these Guidelines were formed conscious of international developments. The guidelines were heavily influenced by external organisations such as the Asian Corporate Governance Association (ACGA), Australian Stock Exchange Corporate Governance Council, California Public Employees’ Retirement System (CalPERS), Corporate Governance & Financial Reporting Centre (CGFRC), CFA Institute Centre for Financial Market Integrity, Global Corporate Governance Forum (GCGF), International Corporate Governance Network (ICGN), International Finance Corporation (IFC) and Organisation for Economic Co-operation Development (OECD). PSE (2009d: 5)

The 10 PSE Guidelines are reproduced below:

Table 25: Ten Guidelines for a Well-Governed Company (PSE 2009d: 6)

- | |
|--|
| <ol style="list-style-type: none"> 1. DEVELOPS AND EXECUTES A SOUND BUSINESS STRATEGY: Shareholder return is optimized through a sound and well-executed strategy. 2. ESTABLISHES A WELL STRUCTURED AND FUNCTIONING BOARD: A well-functioning board creates value for the enterprise. 3. MAINTAINS A ROBUST INTERNAL AUDIT AND CONTROL SYSTEM: Internal audit and controls enhance operational effectiveness, deter fraud, safeguard company assets, and ensure compliance. 4. RESPECTS AND PROTECTS THE RIGHTS OF ITS SHAREHOLDERS, |
|--|

PARTICULARLY THOSE THAT BELONG TO THE MINORITY OR NON-CONTROLLING GROUP: The exercise of shareholders' basic political, economic and governance rights should be facilitated in an equitable, timely and transparent manner.

5. ENSURES THE INTEGRITY OF ITS FINANCIAL REPORTS AS WELL AS ITS EXTERNAL AUDITING FUNCTION: Financial reports must represent a fair and true condition of the company.
6. RECOGNIZES AND MANAGES ITS RISKS: An Enterprise-wide Risk Management system should be in place and properly functioning.
7. ADOPTS AND IMPLEMENTS AN INTERNATIONALLY-ACCEPTED DISCLOSURE AND TRANSPARENCY REGIME: Material information should be disclosed fully, fairly, timely, and accurately.
8. RESPECTS AND PROTECTS THE RIGHTS AND INTERESTS OF ITS EMPLOYEES, COMMUNITY, ENVIRONMENT, AND OTHER STAKEHOLDERS: Corporations should manage the social, environmental and governance aspects of its operations.
9. DOES NOT ENGAGE IN ABUSIVE RELATED-PARTY TRANSACTIONS AND INSIDER TRADING: Abusive related party transactions and insider trading undermine the trust and confidence on the company as well as prejudices non-controlling shareholders' interests.
10. DEVELOPS AND NURTURES A CULTURE OF ETHICS, COMPLIANCE & ENFORCEMENT: Corporate and employee actions should be conducted according to the highest ethical and professional standards at all times.

In a speech to the Institute of Corporate Directors 2007 annual dinner, the Chair of the PSE, Jose Vitug spoke about the importance of corporate governance to the stock exchange and the enforcement by the organisation in ensuring timely disclosure is made:

“On corporate governance, there are legal standards and extra-legal standards. Article 19 of Civil Code is to do things in 'good faith.' The Philippines is blazing in Asia a trail of good corporate governance. This involves an ability to sustain market growth and much could depend on level of transparency and accountability. I did the planning, investing and cooking - but someone else did the eating. For example, our miracle rice [which we did the research and investment in is now used by others because there was no proper intellectual property over it,] so for the PSE, we adopt what we preach.

“The PSE requires companies' websites to reflect real time disclosures. This is crucial to enhancing transparency and accountability. Those who refuse will get a subtle reminder. There is an increase in the list of non-complying companies (which is published annually). The PSE board supports the ICD scorecard which is to develop a culture of compliance... We have tighter disclosure rules such as

blackouts, selective disclosures, 10-minute blackouts, online disclosure systems. We have a form of AWACS (Airborne Warning and Control System) that monitors dubious stock market transactions. One day good governance will be second nature however we need to develop it and that we have to practice and internalise it.” – Jose Vitug, ICD Dinner

Companies that do not comply with PSE listing rules can be subject to delisting:

“Delisting occurs when there is:

- non-compliance with the listing rules,
- inadequate disclosure
- failure to produce required reports

Relisting does not happen automatically. From the investors’ point of view, their loss due to a delisted company will have to be taken into account. An exit mechanism must be at hand for investors.” – PSE

The next section discusses the important stakeholder of the exchange: the role of the brokers in inhibiting and/or progressing future corporate governance reforms.

5.4.6 The Old Boys’ Club – The Brokers

As previous sections mentioned, the brokers of the PSE hold sway over the functions of the exchange. When describing the PSE’s role, interviewees inevitably mentioned the brokers who still dominate and exercise influence in the strategic direction of the exchange. This influence stretched to the listing of a company when brokers, and not professionals, ran the exchange.

To give some idea of the clubby culture of the exchange, a couple of interviewees mentioned instances when companies that intended to list had to go to a special brokers’ listing committee whose members divided the spoils of the initial offering. This control over the listing procedure allowed rent-seeking behaviour to occur as an IPO required the support of committee members before it could go ahead:

“The PSE has gone a long way when it was run by brokers. It was difficult then. The reality is it’s still a broker, old boys club. The smaller brokers make a lot of

noise....Before you could list, you had to go through a brokers' committee." – private sector 1

"[The listing was] not judged on its merits but judged on [their face to face interaction] with the listing committee." –SEC

"[The] listing committee is not a board committee anymore. Before, all IPOs had to go through this committee." – private sector 2

The broker-dominated listing committee does not exist anymore but stories such as these gave the impression of the PSE as epitomising a highly inefficient market where insider information dominated. On another front, pressures towards professionalising the brokers are gaining some groundswell support although some remnants of this culture still exist.

"[My interviewee] started off by saying Australia was heavily involved in promoting corporate governance in the Philippines. I said I was only aware of some aspects – demutualisation of the PSE. On the PSE [my interviewee] mentioned that it had a reputation as a boy's club...The PSE is still an old boys club." – private sector (1) interview observation notes

"We also spoke at length about the problems in the Philippines. He mentioned there was plenty of politicking at the PSE. He said it could take a couple of generations or two before reforms in the Philippines could happen. [The reforms would happen but] not in this lifetime." - private sector (2) interview observation notes

"The old boy's club is still kind of important. They have competitors now so there could be trading in the afternoon. Clearing is operating at T+3 or T +4 days. [There is] no [technical] problem trading in the afternoon. The PSE has the capability of trading in the afternoon. [However, the perception of stockbroking] is a part-time profession as it was a club." -private sector 3

One stockbroker who was willing to be interviewed was the late Irving S. Ackerman, who represented the old guard of the exchange but was not adverse to reform in the PSE. His story is contained in the textbox below:

Text Box 3: Irving Ackerman, Stockbroker

Irving S. Ackerman is an 80-something year old German Jewish-American with a New York twang who – by fate and chance – found himself in the stockbroking business in post-war Manila. He was referred to me by my interviewee at the PSE as a character with stories to tell, one of the personages and part of the fabric of the exchange. Ackerman came to the Philippines as a G.I. during World War Two and never left. The wartime period had a profound effect on his life and a large part of our interview was spent talking about the war and the horrific stories of the period:

“I was in the US Army during the war, a low-ranking lieutenant. We were stationed here just before the war ended. We were suppose to lead the invasion of Japan but luckily we arrived in August 1945 when Nagasaki was bombed. At the end of the year we would have invaded Japan but thankfully it did not happen. We would have fought [a land war] with them [but they surrendered]. Previously I was an accountant in New York City. When the war happened, I was about to graduate, in a city college of New York. [After the war] I married a Filipina and she was a pianist. We married in 1947 and spent 10 years in New York. She was at Juilliard. We returned to the Philippines in 1957. I was with her for 57 years and she died in July 2005. I have remarried since, and my [second wife] helps me in the business.”

Ackerman was one of the ten founding members of the Makati Stock Exchange and the only American. He has a front row seat on the trading floor of the Makati floor. His success in the Philippines was helped by the patronage of several people:

“[When we returned to the Philippines] I was the first and then only stockmarket analyst in the Philippines in 1958. My column was in the Manila Times. The paper was ahead of the [Manila] Bulletin then. Mr Chino Roces, the publisher, allowed me to do this. He helped me a great deal. The same with Max Soliman, he was the publisher of the Star. Chino Roces, Bebing Roces, Benito Pullieto, they were my benefactors, sponsors. The Manila Times called the shots. It was a very good break and [as a columnist] I tried to stay very honest and not shame the paper.”

Ackerman owns a brokerage office and is usually at the PSE (Makati floor) during office hours. Ackerman has seen many changes in his lifetime as a PSE broker:

“The old boys’ club was 20 years ago. The Manila Stock Exchange, it is dominated by Filipino-Chinese. I have a lot of Chinese friends, many Chinese here, Chinese clients. The Makati merged with Manila which became the PSE.

“[In 2007] there is a lot of [hot money] coming in from all over the world. Surprisingly (eventhough the PSE is not known as market maker), the Philippines is looked at due to increase improvements in corporate governance. This country has been working very hard. In the last year or so, efforts have been made so all these years it has been paying off. Stock market news on the PSE is hardly ever on when we’re in the US. There is news on [the stock markets of] Indonesia, Vietnam but not the PSE. But there’s been improved market activity and production. The Philippines has been struggling for years and years to be noted and it is only now that others are getting to know of its existence.”

Ackerman also wrote a book which he gave to me on trading on the PSE: “How to invest and win in the stock market.” Ackerman strongly believed that the future of the

country's stock market rested with local, not foreign investors:

"Currently it's 60:40 (hot money: local money). We have to educate our people. We have courses given in college now about the stock market. We need to educate more people to invest and make investments, some in real estate, manufacturing, stock market etc. [We have to ensure local investment] becomes dominant so it becomes 75:25 (local money: hot money). We don't have to worry about [local] money running away. The money made here, stays here. Hot money is in and out and there is no more profit to be made."

This attitude carried with it a sense of patriotism in his business:

"The firm by choice doesn't deal with foreign investors. We deal 99% with local people."

And a need to develop and strengthen the institution of the stock market before exploring the more exotic financial instruments that have proven to the bane of more developed markets. In a 2000 book that explored the possibility of a derivatives market in the country, Ackerman spoke out in his opposition to its establishment due to the weakness of the institutional environment in the country:

"Now, I think that instead of devoting a great deal of money and time to this wonderful idea of derivatives exchanges, which probably would be something very good for the Philippines maybe ten years from now or maybe fifteen years from now, I think that the government, if it wants to have a matter of national pride, should devote itself to building the stock market...I think that the government should know how to spend its money and it is by having a wonderful program in building the stock market. I am not saying anything about the derivatives but it is just too premature. We need people to understand what stocks are and if they don't understand what a stock is, it would be a little difficult to understand derivatives." (Ackerman in Buenaventura et al 2000: 143-144)

Overall, Ackerman was optimistic about the outlook for the Philippines and the sometime fatalistic environment of ensuring natural disasters do not coincide with human ones:

"The whole economy is showing signs of better health. The GDP is 6% instead of the targeted 5%. It has helped the market, things are getting better so hopefully there's no sudden bad development – hopefully no terrible flood or earthquake or something made by God and made by Man that would be a serious development [to hamper growth]. Things are going steady now. Relative to other countries, it's peaceful. Mindanao – that problem ain't going to be stopped in the near future. It continues, will continue. The Muslim people want Mindanao, but Manila is not about to give Mindanao. All sorts of things: MILF, MNLF – they are gathering strength, they really want Mindanao."

And philosophical about the Filipino way of doing business:

"In the Philippines there is a lot beating around the bush. But things get done eventually."

In January 2009, Ackerman died aged 87 after 45 years in the stockbroking industry of the Philippines. His passing marked the end of an era for the PSE. (GMANews.TV 2009)

5.4.7 External Pressures to Reform

There are two main sources of external pressures to reform at the exchange: regulation from the SEC, and foreign investment and competition. One regulation from the SEC saw increased capital requirements and placed unprofitable stockbroking companies out of action:

“There are 182 brokerage firms here in the Philippines. But of 182, 132 are operating. The 50 have temporarily suspended their activities with the permission of the PSE and SEC. They suspended themselves voluntarily. The reason why these 50 firms have not operated again is the SEC is saying now that in order to open they need a capital requirement of P100M (USD2M). For some of the brokers, it’s a big stumbling block. None have reopened. They need P100M in cash or assets.” – broker

In short, the consolidation of the industry reduced the pool of mostly local Filipino brokers. Filling in this vacuum is the professional brokerage houses which are generally subsidiaries of large foreign investment banks. These subsidiaries have been established throughout the region to parallel the foreign investors present in the area. Foreign investors normally use the subsidiaries of internationally recognised names rather than the local brokers. Foreign investors have driven the trading in the exchange, and it is foreign brokers that drive most of the trading activity on the exchange. Increased trading activity may mean that the favourite broker pastime of golf may recede:

“The number of companies going IPOs and if it continues presumably [will change things at the PSE]. When you get foreign investors in the exchange, a lot of golf goes.” –private sector 1

“Most of the leading (international) brokers are here in the Philippines. There is net foreign buying/selling. The PSE is a small market by comparison to its neighbours. It’s easy to drive the market with foreign money. If there is an increase in trading hours there would be more depth and width. The Philippine market is small so they can only hold so much trading interest.” –private sector 2

External competition has ensured the local monopoly over the PSE has been broken to some extent. However, reaction to this competition has been a source of resentment and

the influence of these new entrants is still quite limited as pointed out by the following interviewee:

“[My interviewee] stated that while the [local brokers] are small they protest a lot and are disruptive even though most of the trading – by volume and price – is done by foreign brokers. He showed me a list of the large brokers in the country and nearly all were foreigners...Of the top 10 brokers there was hardly any locals (except for Ackerman). While they’re the biggest, their influence is disproportionate to the size. The smaller they are the influential they are it seems in running the PSE.” – private sector interview observation notes

Breaking up a monopoly is a hard thing to do. For regulators, well-connected families exercise extraordinary influence especially if they are politically connected. For the brokers affected, the life which allowed afternoon leisure is now slowly disappearing. Unsurprisingly, there is some rearguard action against adjusting to this new way of practising the profession:

“The elites have to be dragged to separate the brokers from the PSE. The brokers are accountable for this brokerage reform. Most [of these small] companies are owned by families with limited liquidity.” – private sector 3

For the time being, the old brokers still have the upper hand as the following interviewee relates how an association of institutional investors failed to get their representative elected to the PSE board:

“The Fund Managers’ Association of the Philippines (FMAP) represent the bulk of institutional investment companies here. They want to be part of the PSE board but they lost the director’s election recently. They’re more relevant to corporate governance, they manage the money. The Secretariat talks to people.” –broker 2

The clash of cultures continues as these groups vie for influence on the future direction of exchange.

5.4.7.1 Reaction to Reforms

The brokers are still very much involved and integral in the reform and transition of the PSE. Given their once dominant ownership of the exchange, the loss of power has meant adjustment for the brokers. In one sense, what is happening with the PSE is the effect of

financial globalisation at the coalface. In this case, the PSE's once insider culture is now exposed to the cyclical uncertainties of financial markets and requires adaption to this new era:

“[The PSE] will just have to [continue its reforms]. It's still partly run by the old boys' club of the old brokers; there' an outsider on the board who is an independent director which is good. The old boys' club is difficult to penetrate. Whoever runs the PSE must have teeth on what he can and cannot do. You need a strong reformer to face down the opposition from stockbrokers and face the old practices. The PSE has now been more proactive. A lot of them are now attending international roadshows.” – broker 1

But as one interviewee pointed out, all market exchanges started in a rather informal manner such as the insurance marketplace established by Lloyd's of London which has its origins in the coffee houses of 17th century England (see Raphael 1995). Nevertheless, if the PSE is to attract more investors, especially local ones, it is important as a matter of confidence to ensure the organisation is able and capable of facilitating market transactions in a timely professional manner, rather than being seen as beholden or biased in favour of one particular interest group:

“[The PSE shows the difference of how a capital market exchange is run] between a developing economy vs. developed economy. A developing economy is a net capital importer. You're competing for deficit capital with other markets. There is an underlying growth of GDP, and you assume this to translate to ROEs. That's your differential, the scales are differential.” – private sector 1

In late 2007, a UK hedge fund, GLG Partners, bought a stake in the PSE allowing them a board seat (a more thorough discussion of GLG is in Chapter 6 in the section on Foreign Investors). The interest of the new foreign owner in the PSE gave some hope in the reform of the exchange:

“As you can determine from comments about golf games, the brokers over here have had a sense of entitlement for far too long and have been dictating how things go for such a long time, that they forget why the Exchange demutualised in the first place, to curb their influence and to manage the Exchange more professionally. I see GLG as an opportunity to finally rouse the PSE and the

market from the particularly ‘Philippine’ way of doing business (word of mouth, old boys club, influence peddling, ‘me first’ mentality, etc) and hopefully get it on the track to think big and compete with the other bourses in the region... it really will take a LOT of time for Filipinos to outgrow bad habits that hamper our growth.” – PSE via text

For exchanges in the region which are now centres of global finance such as Hong Kong, Singapore and Sydney, the transition to a more professional and impersonal organisation has already occurred. The mobility of global capital means countries must adhere to certain standards including a more professional exchange if they are to attract investor interest.

5.4.8 A Small Market

The PSE is one of the region’s smallest markets and one wonders whether the size is due to the organisational culture and limited hours of trading on the exchange, or the exchange reflects the country’s small private sector that is largely dependent on bank financing. Perhaps it is a bit of both.

The PSE’s size means that a few listed, blue-chip companies dominate activity on the exchange. Out of some 250 listed companies, only half are active and the partial listing of companies limits a company’s share activity:

“The biggest problem with the PSE - and it’s not their fault - is the volume is still quite small. The number of listed companies is quite small. The stocks traded are small. The 130 actively listed are quite small. Our business is small – it lends itself to a high degree of manipulation. [You need to] increase the level of liquidity. The degree that is publicly traded is quite small. Infinite publicly trading is very small.” – academic

“On the PSE there are around 130 active companies. There are 250 issues. For USD5M you can rock the market. It’s like USD150M/USD200M per day. It’s a relatively small market, selective...It’s a market that is not developing – it’s a laboratory – as if what big markets are like if you put it in a petri dish and watch it grow. Philippine governance standards as a nature of things are of a small sample.” - SEC

However, others pointed out activity on the PSE in no way truly reflects private sector activity:

“The stock exchange is purely a matter of how many individuals can make money out of others. It is not helping the country.” – consultant

“[The PSE] is sentiment driven market at this stage. [It’s] not accurate. [It doesn’t reflect what’s] on the street, whether the economy’s doing well or not. It’s likely to be cyclical.” – private sector

Nevertheless, the PSE’s size supports Granovetter (2001) and Leff (1978)’s thesis of business groups dominating the business environment where there is stunted capital market development.

5.4.9 Insider Trading

Stock exchanges have always had to deal with problems of insider trading. For the PSE, the exchange’s small size makes it vulnerable to movements due to insider information and the old boys’ club give the impression of a market that is far from transparent:

“There are many small markets that are vulnerable to influences that is not market driven but by insider information. With the exception of the institutions and the intelligentsia, very few people would do whiz bang analysis.” – private sector 1

“The release of information affects stock prices. [There is a] ridiculous amount of insider trading. It is very significant. Our market is small with a few big players who have a lot of huge power and can move the market in one direction. The management is not consistent. You also need to improve the business condition so there’s less insider information and not just stock manipulation. You need to give more confidence so the public are able to purchase stock without these issues. The PSE needs to address these many different type of anomalies.” - academic

Currently, the bourse is divided by blue chip listed companies that can be traded and are seen to be practising timely disclosure and abiding by the rules, and other listed companies that are less transparent and ripe for insider trading and market

manipulation. The onus is on the PSE to ensure that it is seen to practice and have good corporate governance in place:

“The difficulty with the PSE is that’s the place where you need good corporate governance. There is too much insider information in the market place. A lot make [money] on insider information. What foreign investors are looking for are at the fundamentals. When it comes to blue chips versus the rest, the rest are all inside information.” – private sector 2

“The PSE [as a corporation and as a self-regulator organisation] is subject to corporate governance issues and it has had uneven success in its professional management. More people are being engaged in PSE especially to stem those who are key players who can move the stock prices.” – academic

For one interviewee, it comes down to the ownership structure of the PSE for it to ever gain legitimacy in the long-term:

“Other regulatory agencies such as PSE, SEC have been less successful [in implementing corporate governance]. For the PSE it’s a test drive and fundamental in its operations is the ownership of the stock exchange. There are some institutional elements and if not institutional, there is some short-term economic advantage of a few players to encourage speculation on the exchange. It needs tighter standards.” – private sector 2

The propensity of insider trading affects the perception of the PSE as a capable organisation that can operate within the constraints of its internal pressures. Previous past experience of some dodgy listed companies have tainted the PSE to some extent. Market manipulation under the Estrada Administration brought the PSE to near collapse (see Chapter 8: Government Financial Institutions). The following comment explains the psychology of minority investors and their attitudes towards the unregulated and regulated market:

“No, [minority investors] can’t be protected in this environment. It’s the choice of the lesser evil. The OFWs keep their money abroad. There was a pyramid scandal in 2001-2002. It was a scam and the numbers varied but it was approximately

billions of pesos. How here in this country there are so many people who put so much money involved.⁴⁰

“It has happened before. So there are two reasons: These people are stupid. It’s a pyramid so why put it there when you know it’s a pyramid scheme. How effective are the sellers of these schemes? It implies that people are stupid, greedy and irrational. The alternative is before the pyramid [goes belly up] – people make money before it blows up. People made money [in these pyramid schemes] before they [would] invest in the PSE.

“The rationality is there but not for the ruled. [They] make more money though it’s riskier. Still they put money there whatever risk premium is there to put money in the scams than do it legitimately. People think there is no reason they’ll be more protected in the PSE than they will be in the scams. It’s either outright poor corporate governance or lack of transparency. Nevertheless the corporate governance is not improved.

“This indicates the lack of trust in legitimate investments in the first place. It’s either poor corporate governance or if it’s perceived, companies have not been transparent enough to [induce investment]” – academic

This is a challenge to regulators who have an uphill battle to fight against this perception and to show that funds channelled in legitimate investments will be somehow regulated:

“[The] market is very liquid and a lot is to do with foreign investors. But even without the foreign investors, we are becoming more educated along the lines of the capital market. A lot of local investors were victimised by scammers as there’s so much greed. If we can mobilise those funds in the capital market, at least they’d be regulated.” – regulator

The perception that there is no difference between speculating money on the stock market and participating in a Ponzi scheme because the formal institutions cannot be trusted is unfortunately, widely-held.

⁴⁰ During my field research, another pyramidal scheme was uncovered called the FrancSwiss scandal which snared domestic investors (see Lucas 2007b).

5.4.10 Improvements in Enforcement

Some interviewees mentioned the improvements they have seen in the PSE as an organisation, especially in monitoring companies and their adherence to the listing requirements:

“We give credit to the PSE for being aggressive in their disclosure practices. They are aggressive in monitoring. What they see in the newspaper, they send notice. We clarify a lot of notices with the PSE even if the news is from unreliable sources.” – private sector 1

“I think compared to the past years, yes [they have been effective]. Although it still requires improvement, we’re on the right direction now. They are very much monitoring corporations over corporate governance. Unlike before they just give you the regulations, now they’re very strict with deadlines, disclosure and transparency. This is a move in the right direction, we need some improvements, it’s there. They have never been strict as they have until now.” – private sector 2

“The PSE is a well-run company, though it could be more relaxed [in enforcement]. If a Philippine company wants to expand internationally they have no choice but to list on the PSE. So they are corporate conscious. [The PSE] is pretty well run.” –private sector 3

The strong leadership provided and guidance by senior managers in the PSE have set out the culture of the organisation, though it still requires pivotal support from key board members to set out a clear agenda on the direction of the exchange:

“The PSE as a private company has made robust attempts [to regulate]. The PSE requires more independent directors and people are measuring and monitoring that. This is terribly important and the time is right. We have a good leader with Francis Lim. The PSE needs changes. It needs more support especially from the brokers.” – private sector 4

The PSE and SEC, as the twin regulators of the companies, must have the capability of enforcement and be seen to enforce to improve market confidence in the private sector:

“The PSE makes sure companies are transparent in reporting, being fair to all shareholders and discuss Information at more time. People know they are the regulators so the PSE will get the flack for not policing the market. This is true with the SEC, to get the financials in order on time and now with the move to the IAS.”-stockbroker

“Both the SEC and PSE are professional agencies and while other agencies are not...I have not heard of corruption there. We’re not unhappy with the way they have handled their regulatory responsibilities. We would like more of them in other agencies. The PSE is a listed company, and it’s very professional.” – private sector 5

“Maybe on a scale of 1 to 10, I’d give a 3 or 5 out of 10 [for the effectiveness of government]. They are trying to do their best, to improve this thing [corporate governance]. Over the past two years there has been a tremendous effort on their part to improve corporate governance.” – private sector 6

However, reforms within - and enforcement by - these two agencies will be limited if there is no support or similar undertaking from the rest of government:

“Regulation is a function of the macroeconomic environment. It’s a function of government. The PSE and SEC can’t do much if the economy’s not there without the government directing policy. If you see government not being run efficiently, that’s not good corporate governance. That doesn’t encourage good corporate governance. It’s too much to expect [from the private sector] to exercise [corporate governance] when there is no implementation or capacity to enforce corporate governance in the public sector.” – private sector 7

This sentiment was echoed by other interviewees and shows the importance the role government and the public sector play in determining and influencing behaviour in the private sector.

5.4.11 Dialogue, Transparency and Resources

Apart from the general feeling that wider macroeconomic institutional reform should take place, when asked what can the PSE as an organisation to improve its role, some

interviewees suggested greater dialogue with its stakeholders, more disclosure and transparency of its operations:

“Maybe before they issue out new rules, they would invite companies for comments so there’ll be draft resolutions if anybody wants to comment on it. I’ve not heard them have a dialogue. Maybe they should do this, consult with companies about the changes before they implement it. I’m sure they have consultants and experts drafting the rules but if there’s been public dialogue, I’ve not heard of it. We have not received much notice. They publish in the papers if it’s important. They post it on the website so you’ll have to access the website regularly to know the changes.” – private sector 1

“Greater transparency in the regulatory environment of both government and self-regulatory bodies like the PSE will contribute greatly to improve corporate governance in the Philippines. Of course, more transparency should also help control the culture of corruption prevalent in developing countries.” – private sector 2

Human and technological resources are areas that also require attention:

“There are 1000 employees in the Stock Exchange of Thailand (SETI). You need more staff, and structure for bigger listings such as in Thailand– private sector 3

“I was given a tour of the PSE and they had a bookstore. However the latest PSE publication is from 2005 and they are just now catching up, two years later. The delay was due to the reorganisation. The website has the latest updates of the companies.” – observation notes

“The PSE is looking to upgrade the trading system and is looking closely at Thailand’s. We had a look at the ASX’s CHES trading system as well.” – PSE

The PSE is well aware of other developments in other exchanges in the region; however, the regulator is constrained by limitations that originate locally.

5.4.12 Decoupling and the Future

For the present, participation in the PSE is still the domain of a few. Nevertheless, if or when the country economically joins the rest of East Asia, the capital market will parallel

this development. Like any other regulatory body, much of the PSE's function also depends on the political development of the country:

“Politicians want to pass the silver bullet law that can solve everything and have a functioning capital market. Every congressman wants to be in on this law, one bill that will solve everything but it can't be solved properly. There has to be dichotomy that's why [it's important for] capital markets to run under their own steam.” – SEC

Nevertheless, there is a growing sense of awareness that there is a separation going on between the political side and the business side of the country. That is, the capital market is increasingly becoming decoupled and running independently of political events of the country. The following interviewee talks about this wall:

“There's something lasting to do with the legacy of the President Macapagal-Arroyo. A wall has been erected on the effects of politics on the PSE – between economic activity and political activity. We don't know how sturdy it is but it is a wall now. You can have a mini-rebellion by the military and the market is unaffected. The market continues to operate on its own. There are signs of that being in place. There's many a time that has occurred in Japan as well – the government changes, the government falls but the stock exchange goes on. It's the same when [former US President] Clinton was impeached. That's the only way to go.

“This wall has been set up Gary Teves, good advisers like Salcedo...hopefully [the PSE will be] forgotten [by politicians] until the 2010 [presidential elections] so the masonry continues on the wall! Once [the wall] gets established, it will be fluxed out of the political arena. You can also gauge political will. If you look at politics, there is an outstanding wish to separate [the politics] from the economy. It's difficult for politicians [not to interfere and do] something and make it happen. The economic argues against its each other. Many programs are common. When the wall increases, then you will realise the separation – like separation of Church from State. Then you can have a synergistic distinction.”-private sector 1

This distinction was supported in a comment by then Economic Planning Secretary Neri that business has finally been able to create a wall despite the frequent political

intrusions:

"Our businessmen are able to put a firewall between economics and politics at the moment. But in the long run, the effects of political risks on the economy could be worrisome. Our political institutions are still rather primitive and almost tribal with a lot of political killings. We need to have social trust to achieve a higher economic growth in the future. Social trust and economic growth has a correlation." - Economic Planning Secretary, Romulo Neri in Remo (2007)

Perhaps, one day the PSE as with the rest of the private sector and the bureaucracy, will be able to function despite or in spite of political upheavals. The future of the PSE as contributor to improved corporate governance in the country will continue to depend largely on the substance of its own governance practices, by the perception from the companies that it seeks to regulate, and its independence and ability to discharge its duties without fear or favour.

5.5 The Insurance Commission

The Insurance Commission (IC) has regulatory oversight over the insurance industry. Its mandate is "to regulate and supervise...to ensure that adequate insurance protection is available to the public at a fair and reasonable cost and to assure the financial stability of the insurance industry so that all legitimate claims of the insuring public are met promptly and equitably." (IC 2009)

Compared to other government agencies, one interviewee regarded the Commission as second only to the BSP in terms of the effectiveness of its enforcement:

"In a list of most effective government agencies, I would say it'd be 1. BSP 2. Insurance Commission 3. SEC." - ICD

Amongst interviewees, there was a grudging respect for the industry regulation provided by the Insurance Commission:

"The Insurance Commission is big and large and given the resources it has, it is run very well. The industry is managed pretty well from a regulatory sense. It is very strong, it is quite strong on corporate governance issues. It recognises a way

to go. It has progressed with a series of things that ensure companies are prudentially managed. At the end of the day, the fundamental concerns [the Commission have] are that you're not ripping off your clients and that you have sufficient reserves to pay the claims." – private sector 1

For a sector to be effective, a strong regulator is also required. This section looks at the insurance industry in the country, the regulator, and the particular events surrounding the departure of an Insurance Commissioner.

5.5.1 Insurance Industry

The insurance industry is premised on the purchase of products that have a promise attached to them but with an indefinite discharge. According to one interviewee:

"When you buy financial instruments (e.g. mutual fund): for the investor you buy it due to a promise on future ROI. With an insurance product you never know when it will be fulfilled. Investment products are a liquidated promise" – private sector 1

In the Philippines, the insurance industry in the country is characterised by a concentrated few players in the life insurance segment, and a widely fragmented non-life or general insurance segment. In the 1990s, the industry was opened to competition allowing 100% foreign ownership although capitalisation and residential requirements differ between local and foreign operators:

"There is an X amount of capital, certain portion that must be present in the home market to establish the corporation. The shareholders can represent equity but there are residency requirements for directors. E.g. 60, 70% of the directors must be residents though, they are not required to be citizens." – insurance company

According to Ghosh (2006), there is still scope for growth in scope and coverage in the Philippines. Total insurance penetration in the country was at 1.5% in 2004 (2006: 139) while total insurance penetration was at 1.5% in 2004. Total density for both segments decreased from 1997 to 2004 due in large part to a downturn in coverage in the non-life segment. Similar to other countries in the region, the non-life segment of the industry is

far more fragmented than the life segment, the exception being South Korea where there are more life insurance companies as the following table shows:

Table 26: Indicators of Concentration in the Insurance Sector (Ghosh 2006: 140)

Economy	Year	Herfindhal index ⁴¹		Number of companies			
		Life	Non-life	Life	Non-life	Composite	Total
China	2004	1803	3684	n/a	n/a	n/a	n/a
Hong Kong	2005	926	229	46	110	19	175
Indonesia	2004	811	478	n/a	n/a	n/a	n/a
Malaysia	2003	1683	460	7	26	9	42
Philippines	2004	1439	424	34	97	4	135
Singapore	2004	1989	588	6	42	7	55
South Korea	2004	1846	1622	22	17	-	39
Thailand	2004	2527	439	24	71	-	95

Ghosh suggests that the widely-fragmented non-life sector gives room for further rationalisation. He sees consolidation of the insurance industry given the current heterogeneous landscape of the sector and future prospects of companies to reinvest in the growing capital markets of the region (2004: 140). Furthermore, the different regulatory oversights over insurance products that deliver the same elements mean there is duplication. Therefore the sector in the region will undergo major institutional reforms at some point.

The next three sections look at two segments of the insurance industry: life insurance and non-life insurance; and a segment that ought to be regulated by the insurance regulator: the health maintenance organisation (HMO).

5.5.1.1 Life Insurance

The life insurance segment in the country is dominated by large players both local and international. Since my data collection, the biggest event that shaped this segment was the problems of American insurance giant American International Group (AIG) which

⁴¹ The Herfindhal index is defined as the sum of squares of the market shares of each individual firm. It ranges from 0 (competitive or equally distributed) to 1 (monopolistic or dominated by one firm). Alternatively, it can range from 0 to 10,000, if percents are used as whole numbers (e.g. 75 instead of 0.75). World Bank comparisons across markets suggest that a Herfindhal index value of around 1,200 to 1,500 would be the natural range for non-life insurance markets, and because of greater economies to scale and lower concerns of risk aggregation, around twice that level for life insurance.

played a pivotal role in the global financial crisis of 2008 and had a major presence in the region. At the time of writing, its Asian assets (now known as AIA) have been subject to different acquisitive overtures by other companies (see AIG section later in this chapter). Notwithstanding this event, this segment is generally considered as well capitalised:

“The life industry is much better managed as it is a smaller market which is the nature of the industry. There are foreign companies as well more in life which drives the changes and standards. In life there are 30 companies. 15 would be foreigners. It’s an 80:20 principle. 20 companies run 80% of the business. From the top group, only one would be local. Ayala/Insular Life is in the Top 10. The two biggest are AIG and Sunlife. It’s a toss-up between AXA and Insular. There is also Manulife/Prudential (UK). There are major innovators that have been foreigners.” – private sector 1

Foreign-owned insurance companies and locally owned large insurance companies have driven the introduction of good corporate governance practices in this segment.

5.5.1.2 Non-Life Insurance

The non-life segment of the industry is characterised by small players and is heavily fragmented. It is dominated by family-owned and operated businesses.

“There are many products that are being insured in the non-life segment. A lot of companies on the fringe are on motor vehicles, lines of business that lends itself to corruption. The [non-life segment is] diverse, difficult to manage. The regulators are grafting on this issue, there are minimum requirements. The other is to [have the capacity of] policing. The non-life insurance industry is more difficult. It’s difficult to generate a ROI as it is competitive and fragmented. The opportunity to generate profit is difficult. Of 100 companies in non-life there are 10-15 that would be foreign. One would be a significant because of its history (AIG) but mostly it is run by SMEs...” – private sector 1

“While the life insurance industry is deemed strong in terms of capital, “the non-life is characterized by a large number of very small, family-owned firms that are inadequately capitalised and operationally weak.” (Milo in Balea 2007)

The numerous players in this industry have also stretched the resources of the regulator to oversee this segment:

“The problem with the industry is that on the non-life side you have too many companies. The small companies are not run really well. The practices that do go stretch the Commission’s resources.” – private sector 2

Due to the variety of players and products in the non-life segment of the industry, this segment continues to be a regulatory challenge.

5.5.1.3 Health Maintenance Organisations

The other segment worth mentioning which is not regulated under the Insurance Commission is the Health Maintenance Organisation (HMOs):

“There are two types of industries insurance and HMO providing similar products. One is well regulated, and the other one isn’t.” – private sector 1

The HMO is overseen and regulated by a division of the Department of Health. HMOs are ‘easier’ to set up:

“All that is required is to satisfy the application requirements - that is, to meet a half page of items, then an annual simple audit, and submit the audited financial statements, then [the Health Department] issues a licence to renew the business. The same thing happens in the insurance industry but it is more extensive.” – private sector 1

There is a wide gulf in the manner of regulation between the Health Department and the Insurance Commission. HMOs currently face a series of challenges due to issues of scale, scope, competition, misuse of short-term/long-term financial instruments, and lack of professional managerial experience. The following interviewee articulates these problems:

“The HMO industry is not managed. There are 16 participants in the HMO industry. Most of the health insurance is provided through the HMO industry, companies. There are some 20M people covered. But the benefits and the levels are not huge. It is not governed. There were 38-40 participants before but is now down to 16.

“[The nature of the industry is] it is demand driven by employee benefits. The funding for the payment of medical services is very competitive. There are a lot of amateurs entering the business and they are simply being irresponsible in the

pricing of their products. They enter with a low price and the claims have a high price. The claims are higher than expected. The loss of money in the first year is a lot. Some HMOs have been set up by doctors. They use the money to buy property but it's a cash-flow business. How do you fund your claim when it's in property? 60% or more (of the funding) go into (paying the) claims. If you use the money you can't pay your claims so it has a bad reputation of mismanagement, irresponsible decision making, no right treatment but no obligation.”-private sector 1

The failure to implement or practise corporate governance in this sector is symptomatic of the operational vulnerabilities of the industry:

“The financial characteristics of the environment to get into trouble are still there. There are no corporate governance guidelines. There is an industry association which is trying to set up rules. But there is no policing. So it's badly run, it suffers in the end with the insured in the market place.

“Our HMO lost about P70M over a period from late 90s to 2004. It wiped out the capital. It was insolvent when I came in. It had to be recapitalised by the purchase of it by the insurance business so it's now a wholly owned subsidiary. It was a limited business but is now back on its feet. This is typical of what's happened in the industry.” – private sector 1

At the time of writing, the Insurance Commission is understood to be interested in regulating the HMOs:

“The Insurance Commission is quite happy to do it that way to have the HMO under its purview. The Insurance Commission wants to strengthen the industry with regional counterparts so they have capital requirements. Meeting those requirements – risk based capital will lead to better financial, prudential management so that there is a certain margin of reserves, liabilities. At the end of the day, the minimum capitalisation required is quite low.” – private sector 1

Given the core responsibilities of the Department of Health, the Insurance Commission would have the resources, the expertise and understanding of the financial instruments offered by HMOs.

5.5.1.4 Fraudulent Claims

The nature of the industry means separating the fraudulent from the legitimate claims is part and parcel of the operational challenges for insurance companies. Claims processed in USD are heavily scrutinised. The following insurance interviewee describes the company's bureaucratic processing of claims in order to prevent fraud:

“Our core service is medical, but a lot of it is grey. We are tight against fraud. In the Philippines there is a lot of non-compliance with requirements on the application form. We ask people to disclose e.g. health problems. Policy conditions have to allow for non-full disclosure. So the policy is quite tight. If there are pre-existing conditions whether there can be a debate between the doctor, client and company, it's a grey area. We're quite tight. We're strong in doing the right thing and take on faith but tight on requirements on claims. We require original receipts. So we're quite bureaucratic. So people complain.” – private sector

Claimants who wish to be treated in American hospitals are heavily scrutinised:

“There are weird and wonderful schemes going on here in the Philippines. Our dollar products are to international standards. If you want treatment in USD, we are very careful regarding fraud. The other day, we were collecting information for a claim form that was doctored and submitted for processing. Instead of under \$6,000, the claim was under \$60,000. It was a clear case of fraud. So we have a few sorts of claims like these and they hurt. It's also in the nature of the indemnity that lends itself to fraud. So we have to be quite tight for example on people who know they are ill. There is poor medical care here so they take the chance to do it, going from one insurance company to another. If it doesn't work, it doesn't work.” –private sector

For one travel insurance claim, the fraud was easily discovered:

“For travel insurance, someone submitted a claim in Turkey. It must have been for around \$400, we processed it. There was an audit check. We got a translation for it. It was a bar tab – food, drinks. It's a problem in the industry. There is the cost of getting a certified translator as well.” – private sector

However where there is a dispute between a claimant and an insurance company, my

interviewee noted the Insurance Commission tends to support the claimant:

‘In terms of the insurance regulation – when you have situations of conflict between the companies and the policy holder, the regulators tend to favour the policy holder. We would settle the claim amicably, even if it’s not valid. It is little more than influence. Some of it does go on. It’s not major corruption bit minor things. For the most part the insurance industry seems to be clean except for ‘suggestions’ or ‘advice’ of easing policy restrictions on certain policy holders.’ – private sector

For a privileged few, there would be informal pressure to approve claims reflecting the strong-arm tactics of a well-connected client:

“For example, it was suggested that we make a partial settlement on a claim though it was not valid but suggested it was a good thing to do. The reality was this was due to the personal connections of a claimant. It hasn’t been settled. In my 10 years, this is the first time it has happened. We would settle the claim amicably, even if it’s not valid. It is little more than influence. Some of it does go on. It’s not major corruption bit minor things.” – private sector

Preventing fraudulent insurance claims is part of doing business of the industry.

5.5.2 Corporate Governance Reforms in the Insurance Industry

The main corporate governance reform that was introduced into the industry was the Insurance Code of Corporate Governance in 2002. It is part of the ongoing reforms in the regulation of the industry:

“It’s getting together. The Insurance Code is being revised, reviewed – it’s being tightened. It’s at the early drafting stage between the regulator and the industry. It’s going to modernise the industry, it’s dealing with prudential requirements, sales, corporate governance. It will have much more teeth; it will build in higher fees and fines. Some regulations don’t give the regulator flexibility needed. Any change has to be legislated.” – private sector

The Insurance Code was introduced before the SEC Code and further updated at the end of 2005. The main difference between the Insurance Code and the SEC Code is the

requirement that insurance companies separate the role of Chair and CEO/President.

The SEC Code only requires a justification for the combination of the role:

“The corporate governance code indicates that the Chairman shall not be President which is not in the SEC code...the insurance industry is cognisant of corporate governance.” – private sector

The Insurance Commission shares the same sentiments as the SEC in emphasising further company director education and training but take a more stringent approach in its enforcement:

“Under the regulation of the Insurance Commission, the corporate governance standards in places are weak, and in some places are strong. There are rules and courses for corporate governance training. The Commission would also penalise the company if you didn’t go through the training. The ICD training and courses are basic on what directors should be doing. All executives, directors and officers have had to attend it. It is a way of introducing corporate governance. There’s a self-governing checklist and we have to submit. It covers typical things an organisation should be following. But it takes time for corporate governance to be seriously considered.” –private sector

“The Philippine government institutions show their commitments on raising the corporate governance standard by implementing Code on Corporate Governance applying to local corporations, including insurance companies. Besides (and we speak only of the insurance industry), all directors or trustees of insurance companies, reinsurance companies and mutual benefit associations as well as officers with a rank of Vice President are required to attend a one-day training and orientation course on corporate governance conducted by duly accredited training providers of the regulator.” – Manulife

The Code also provides for the rotation of auditors:

“The Insurance Code provides changing external auditors every 3 years. Our current auditor is in its second year of auditing, the board selected the auditor from an accredited list. In order to make that list the auditor had to have Insurance Commission accreditation, meet licensing standards, experience of audit, be in the industry and compliance with IAS.” – private sector

Similar to SEC regulated companies, audited statements are the main way for the regulator to ensure companies in the industry are complying with its requirements:

“We provide copies of our audited statements. The audit reports meet international standards. For the insurance industry, it’s an accreditation requirement, an audit for the insurance company, and to certify certain standards of audit so the licence can be renewed. The SEC is required to receive a copy of our audited financial statements. The Insurance Commission does annual audits and is part of their regular review. Under accreditation standards, the auditor is an agent of the regulator and the auditor has to report any activity that is unscrupulous.” – private sector

Unlike the PSE, there are no corporate governance guidelines for insurance companies. According to my interviewee, this is to the detrimental to the industry:

“There are no corporate governance guidelines. There is an industry association which is trying to set up rules. But there is no policing. So it’s badly run, it suffers in the end with the insured in the market place. The major MNCs do corporate governance on a stringent level than the locals. It would take a big education campaign. Corporate governance is more about education than anything else.” – insurance company

While corporate governance has taken a foothold in the industry, the main insurance reforms that have had the most impact are aspects of the Code that tightened and increased the capitalisation requirements. They overshadowed the nascent corporate governance reforms as the main thrust of these capitalisation requirements was to consolidate the non-life segment of the industry.

During my data collection, a standoff occurred between the lobby group, the Philippine Insurers and Reinsurers Association or PIRA representing 93 non-life Insurance companies and the Insurance Commissioner. This episode was an insight into why any regulatory reforms in the Philippines can be protracted and how the political appointment system gives way to instability.

5.5.3 The Ousting of the Insurance Commissioner

The Insurance Commission was one of the regulatory institutions I wanted to discuss

corporate governance with. Unlike the other three regulatory institutions that directly dealt with corporate governance in the private sector, I was not successful in interviewing the then Insurance Commissioner, Evangelina Escobillo. I later found out that my data collection period coincided with the turbulent time for the organisation and the industry in general.

Escobillo, amongst three interviewees, was held in high esteem as a reputable, highly competent public servant and reformer:

“The government has been effective in the industry. The Insurance Commissioner Escobillo has actuarial training and is a highly accomplished technocrat. She used to be the Landbank (government-owned bank) head...The previous Insurance Commissioner was kicked out, asked to resign as he had alienated quite a few people. There is a lot of politics behind it. Escobillo is tough. She’s heading in the right direction. By and large [the Insurance Commissioners] are political appointments. The last two commissioners have been political, the other was a career man. What’s good about Escobillo is that she’s a technocrat. She knows what she’s done. Her background lends that experience to a regulatory institution.” – private sector 1

“[I asked him about the brouhaha over the insurance commission’s consolidation and reforms] The consolidation of the insurance industry, it has already happened in the banks. She won’t be out of a job. Vangie knows what she’s doing.” – private sector 2

“Insurance Commissioner Escobillo has been very active in improving governance in the sector.” –BSP

However, one interviewee made an off-the-cuff moment that encapsulated the feelings of those who did not share the same sentiment as the above three:

“I’ve spoken to some of the insurance industry owners and they can’t stomach that woman.” – private sector 3

In June 2007, Escobillo tried to implement reforms under Department Order 27-2006 (Insurance Memorandum Circular, 2006), which would increase the capital adequacy requirements of the firms the Commission regulated (Balea 2008). The reforms would

directly affect the operations and viability of the smaller insurance companies in the non-life industry. The Order was well received by the large life insurance players (Remo 2007c) but strongly resisted by non-life firms headed by the industry lobby group, Philippine Insurers and Reinsurers' Association (PIRA) (Remo 2007d).

Lobbying against a reform that disagreed with one's circumstance proceeded to full effect, including muck-raking to undermine the reputation of the Commissioner:

"The Insurance Commissioner [Evangolina Escobillo] wants to make changes and has stepped on a few toes and alienated some powerful people. Even if the company is a small, the principal could still be powerful and well-connected...[in the Philippines] if you don't like someone, you tend to do some rumour-mongering. The major players have not been alienated but [she has alienated] some powerful players who run small insurance businesses." – private sector 1

A full-page newspaper ad paid for by the lobby group, PIRA, criticising the Commission's reforms appeared in the Philippine Daily Inquirer on the 8th of June 2007 as the scan on the next page shows.

I sent PIRA a lengthy email asking if they wished to discuss their criticisms of the regulator in the ad and the reforms in the industry. In particular I was interested in the second last sentence of the ad as I found it unusual to see corporate governance applied in such a context.

"We need an Insurance Commission that would guide us in transforming the industry cognisant of the need to protect and serve the public, and compliant with the principles of Good Corporate Governance." – PIRA ad

PIRA never responded.

I asked a couple of my interviewees what they thought of the lobby group's ad. One pointed out the political nature of the ad:

"The PIRA Ad - the Commission jumped the gun on releasing the information. It's based on poor information. There is also a political reason behind it. The Commissioner is trying to make changes to strengthen the industry but notwithstanding that, in response by the Commission and the Department of Finance, that the insurance industry is not paying sufficient taxes. That's not

true. Much of the industry has changed that affects the tax application. There are lots of products and premiums. The industry doesn't withhold their tax payments." – private sector 1

Exhibit 8: Scan of PIRA advertisement in the Philippine Daily Inquirer, 8 June 2007, p.A17

So The Insuring Public May Know

Recently, the Philippine non-life insurers have been criticized in the media about under payment of 2006 taxes and under capitalization by its own government regulator, the Insurance Commission. The industry has resorted to this paid advertisement so that the public may know the truth.

1. 2006 P8B TAX UNDERPAYMENT NEWS NOT TRUE.

The recent announcement of the Insurance Commission that the insurance industry owed the government some P8 billion in unpaid 2006 taxes is erroneous and truly unfair.

The news erred in that the Insurance Commission's computations did not exclude VAT-exempt premiums of medical/PA policies and zero-rated VAT for PEZA locators, but included VAT on accounts receivables that are only due when collected in 2007 and income taxes payable in April 2007.

Without doing any validation with insurance companies, the Insurance Commission summarily issued an announcement that unduly prejudiced good corporate taxpayers by labeling an entire industry as tax cheats.

The partial results of an ongoing survey being done among non-life insurers show that paid taxes increased from P2.36 billion in 2005 to P2.5 billion in 2006 (documentary stamps tax, VAT, fire service tax, local government taxes and income taxes).

The VAT and DST taxes at 24.5% of premiums are the highest in terms of percentage of non-life premiums in all countries in Asia and most countries in the world.

2. CAPITALIZATION NEWS PREJUDICIAL TO INSURERS.

The past year, the Department of Finance, upon the recommendation of the Insurance Commission, imposed a higher capitalization requirement on all insurance companies in a bid to lift the industry to the level of more developed countries.

Though it is widely believed that the new requirement was fiscally premature given the size of the market and the country's economic realities, still we all are doing our best to comply with the Risk Based Capital implementation.

Notwithstanding, the Insurance Commission jumped the gun and announced the names of 15 companies that have allegedly failed to meet the 2006 capitalization level. The announcement was reckless to say the least as it included even companies that have capitalization higher than the requirement. These companies suffered cancellation of policies and bank accreditation and lost renewal business due to the negative news.

The Insurance Commission's publication of unverified data again undermined the integrity and credibility of the named companies who were compelled to issue press releases just to be vindicated and their side heard. The industry suffered peripherally and, somehow, lost credibility with the insuring public.

3. INSURERS DESERVE DUE PROCESS.

The Insurance Commission has been issuing many circulars, some of which were without sufficient consultation with industry players and without appreciation of market realities. Recently, there was the difficult requirement for insurance brokers and agents to secure a P1.5-million guaranty payment bond at a prohibitive cost of P40,000 to P50,000 with collateral which is all out of proportion to the P3,600 minimum insurance income prescribed in the Insurance Code. The new requirement would result in disenfranchising small and provincial agents from turning to the non-life industry for life-giving income. In a country with noticeable unemployment and underemployment, this action restricts the nationwide opportunities for job creation.

The recent acts of the Insurance Commission that unduly embarrassed the industry could have been avoided had there been open lines of communication between the Commission and industry players. The non-life insurance industry has been in existence for over 100 years now and we recognize that change is inevitable and it can even redound to the benefit of both the industry and the public when an atmosphere of respect, open and constructive dialogue as well as positive action is cultivated.

We need an Insurance Commission that would guide us in transforming the industry cognizant of the need to protect and serve the public, and compliant with the principles of Good Corporate Governance.

More than anybody else, the Insurance Commission should realize that public credibility is the cornerstone of any business and our industry is determined to uphold this even in these extremely trying and uncertain times.

Philippine Insurers and Reinsurers Association, Inc. (PIRA)
Umbrella organization of 93 non-life insurance companies in the Philippines

Another interviewee was in disbelief when I showed him the ad. In the context of using corporate governance to promote their argument, he responded:

“Escobillo is looking at the actuarial risks of insurers and so she raised the capital requirements. PIRA is representative of small insurers. There are a lot of small companies. The small companies are not happy with the taxes and they are not happy with Escobillo raising the capital requirements. So they squealed... Good corporate governance starts with corporations and their fiduciary responsibilities. [The small companies] invoked good corporate governance in the PIRA ad as eventually everybody would invoke God.” – private sector 4

Thus, in the case of this ad, the corporate governance discourse effectively requested the opposite. Corporate governance had become a loaded phrase with political overtones. This very public display of open conflict between the regulated and the regulator is unsavoury in Filipino culture. Why such a public display? According to my interviewee, it was a struggle for power of the regulated trying to impose its will on the regulator:

“It’s nothing personal is the message [of the PIRA ad]. Never tell the regulator to her face that you’re being unfair. We don’t like confrontation here. There are ambiguities. Some things never get resolved. PIRA wants power of appointment. Their message is: regulators who can’t handle people they’re regulating should be kicked out. By invoking good corporate governance, they’re taking the high moral ground.” – private sector 4

Given how the reforms were seen as a way to largely promote, consolidate and reform a fragmented sector the news of Escobillo's sacking in August 2007 did catch me by surprise:

“President Gloria Macapagal-Arroyo sacked Insurance Commissioner Evangeline Escobillo whose tough reforms had earned her many detractors along with several graft charges, by accepting her courtesy resignation. She is replaced with one of her predecessors, ex-IC chief Eduardo Malinis⁴²...Reports of Escobillo's replacement circulated in June, amid calls for her ouster by public-transport and insurance agents and brokers because of her alleged counterproductive decisions.” (Gonzalez 2007)

Such is the start-stop reform process in the Philippines. The attacks on her person proved to be too much and so the issues that were underlying her reform remained. She was replaced by the previous commissioner who would not rock the boat as much. The departure of the Commissioner was a common occurrence in the country. Regulatory authorities who are openly defied by those they regulate are not supported by the executive (see Chapter 9). This episode was an open display of the government not supporting its public servant or the reforms she was instituting. This echoes Ghosh's observation that the current regulatory environment deters regulators to make substantive changes. Even if regulators do wish to exercise their duties, forced resignations or legal actions – as in this case - are direct consequences of pro-active regulation⁴³.

5.5.4 AIG and the Effect of the Global Financial Crisis on the Insurance Industry

On 21 June 2007, I attended a joint Foreign Chamber of Commerce Luncheon with the

⁴² In Tagalog, *malinis* means 'clean'.

⁴³ “Several factors may deter regulators from tackling substantive issues. The first is a lack of industry knowledge and experience, which is natural given that regulators are often drawn from civil-service backgrounds, but difficult to address unless salaries can be made sufficiently attractive to attract practitioners to work in regulatory agencies. The second is a lack of protection from legal action; this can be addressed by laws granting suitable immunity. Third is a fear of political interference or of displeasing powerful market participants who could separate them from their jobs. A high turnover of regulatory staff, who are commonly rotated across departments, ministries, or agencies, or headhunted by the market, can also reduce an agency's capacity to retain the necessary knowledge and expertise and thus the capacity to regulate effectively. A final factor that can seriously compromise effective enforcement is fragmented regulatory mandates.” (Ghosh 2006: 147-148)

then British CEO of the then largest insurance company in the world American Insurance Group (AIG), Martin Sullivan, as guest speaker. Sullivan was on a flying visit of the East Asian subsidiaries of AIG. AIG through its subsidiary PhilAm Life has had a presence in the Philippines since 1947 and celebrated its 60th year in the country. In his speech to the audience, Sullivan emphasised the potential growth of the country:

“AIG wishes success in the Philippines so that it can catch up and experience growth like the rest of Asia. The Philippines can be the bridge between the USA and East Asia.” - Martin Sullivan, 2007 AIG CEO

On the issue of corporate governance, Sullivan emphasised the importance of transparency:

“Transparency in corporate governance [is necessary] to attract FDI. In attracting FDI, there must be connected standards and a transparent level playing field in the country. All must be playing on the same field if you’re looking at investor confidence and increased trade in country. Transparency is important in the level playing field. Nobody wants corruption. You can be compliant and have good corporate governance. It is not mutually exclusive. The last thing any investor wants is corruption and increased corruption reduces foreign investment.” – Sullivan

I submitted a question asking Sullivan his views about the challenges and weaknesses of the corporate governance environment in the Philippines. He paused as he could not answer for the Philippines but instead, he spoke about the experience of AIG in the mid-2000s when the company had been targeted by shareholder activists over accounting irregularities (Minow 2008). He stated the company was undergoing internal reform:

“Good governance is expected for all corporations around the world. They vary but they shouldn’t. Before we received a 2/10 score in corporate governance in the USA. Now it’s 9/10. We are now a role model of corporate governance 26 months after the corporate crisis, and we are asked on corporate governance. The Philippines needs to establish to clear and transparent guidelines for people to comply with to promote the sustainable development of the Philippines.” - Sullivan

Sullivan also spoke of AIG as a good corporate citizen being at the vanguard of the climate change debate:

“We have a clear position on climate change. We were the first US insurance company with a climate change policy. We are the world's largest environmental insurer. In the climate change arena, we look at carbon testing, and CSR in investment strategies. We are investing in companies that take CSR seriously. You can believe the science or not but our planet is becoming a warmer place. If we're good citizens, we'd be creating life for generation after generation.” - Sullivan

Later that year, the global financial crisis erupted and AIG was caught in the centre of the maelstrom as the underwriter of unsavoury financial instruments that underpinned the present crisis. (Shelp 2009) This event exposed the hypocrisy of Sullivan's rhetoric. He, whose hands I briefly shook at that luncheon in June 2007 and who spoke of good corporate governance, had presided over the near-extinction of his company. (Sherwell 2008)

The recent CEOs who were in charge of AIG were paraded before the US Senate Committee. (US House Oversight Committee 2008) AIG was bailed out by the American government and was deemed too big to fail given its extensive and web of business interests in the USA and around the world including the Philippines.

The AIG near-collapse has had two effects, firstly on the immediate future of its Philippine subsidiary and secondly, the effect on the insurance industry in general. At the time of writing AIG's Philippine subsidiary, PhilAm Life held a 35% market share in the industry. PhilAm Life's assets were P108.3B in December 2007, a third of the entire industry's P367B (Rimando 2008b). In a follow-up interview I conducted my interviewee submitted a coda on the effect of AIG's collapse:

“PhilAm in the Philippines has around 35% of the life insurance market and it is up for sale. A couple of PhilAm's subsidiaries have already been sold (e.g. its bank). AIG is selling many assets around the region and is looking for minority partners hopefully to support repayment of the loan. While it is true that “AIG” could go down, the reality is that AIG cannot access policyholders' funds which are held in trust – under any circumstances. While there would be much

uncertainty if PhilAm's parent went bust – policyholders here would be ok.” – private sector (2009 update)

Reforms that Escobillo was trying to implement in 2007 to increase the financial war chests of insurance companies in order to absorb external shocks were similar to the unpopular reforms that the banking regulator had undertaken earlier (Balea 2008). The piecemeal reform of the insurance industry has resulted in the country lagging behind the region and the weak capitalisation of some of the smaller firms has deterred consumer confidence in the sector

“The regulator was apparently caught between a rock and a hard place. Chiong explained the order would guarantee the safety of investments of consumers, but was too ambitious for small players whose sales and returns are not really that high. She said they had to compromise.”(Balea 2008)

“Insurance industry reforms are progressing in a typical fashion – where differing parties views are accommodated in respect of implementation of new regulations. Commissioner Escobillo was dismissed (and I believe no longer in the country) and the retired commissioner (Malinis) is back until President Arroyo leaves office in 2010. The increases in required capitalisation progresses albeit at a lower rate while the other aspect – risk based capital has been shelved. Previously suspended companies are again operating.” - private sector(2009 update)

The global financial crisis and the fate that befell AIG echoed the 1997 Asian crisis and the near-collapse of pre-need companies. The reforms instituted by Escobillo were vindicated by the events of 2007-2008.

5.5.5 The Future of the Industry?

Similar to other parts of the private sector, a two-tiered standard of corporate governance and professionalism exists in the industry. The leading players have gone beyond the minimum capitalisation requirements in place so they can be in synch with the rest of the region. The smaller companies face consolidation and greater competition. It is foreseeable the Insurance Commission will be occupied in appeasing the smaller players. Clearly, there are problems and challenges in how the industry is

regulated. One interviewee suggested that the structure of the regulatory bodies be themselves reformed in improving the corporate governance of companies:

“I’ve tried to reconcile the SEC and Insurance Commission corporate governance standards. The SEC’s is quite detailed but it doesn’t address the insurance industry. There are a number of independent corporate governance standards that are issued [and the issue is] which has the higher priority. The Insurance Commission answers to the Department of Finance. What can be done in the financial services could be a review of the structure of the regulatory bodies themselves. Look at the financial services industry in Australia which is under one umbrella –it is streamlined across several industries...perhaps [here they could have] an administrative split into consumer and prudential aspects as there is a long way to go on the consumer side here.” – private sector

Regulatory institutions in the country are not strong and the independence of the regulators is easily undermined. Public displays of dissent are common and when there is a lack of support for the reforms (from the regulated and/or the executive) then that undermines the imprimatur of the regulator as the arbiter, and referee of a level playing field. The Insurance Commission is indicative of this. All regulators covered in this chapter are in different stages of becoming truly independent – independent of government, politicians, and vested interests. Until such a time when strong, independent regulatory institutions are unequivocally supported, these organisations will find it challenging to be able to function and exercise their duties, instil consumer confidence and gain wider public legitimacy.

CHAPTER 6: BUSINESS GROUPS - THE OWNERS OF COMPANIES

This chapter looks at the issues of ownership for companies, and the internal and external challenges they face. In the Philippines, most companies are part of large conglomerates known as business groups. Business groups are the most common form of corporate organisation outside Anglo-American countries.

The chapter is divided into the following sections:

- An introduction on family-owned business groups as the dominant form of organising in the Philippines, their dominance, ensuring family control, the holding company, cross shareholding and the experience of business groups under the Marcos dictatorship.
- Financing business groups is mostly through banks but the capital market is providing another outlet; the owners' attitudes towards listing on the local bourse are explored.
- Complementing the previous section, the investment strategy of business groups are discussed and the portfolio strategy of their holding companies. Competition between business groups and the present and future investment opportunities in the country are mentioned.
- Relationships with outsiders are explored in the section on shareholders and stakeholders of the company. The importance of the majority shareholder is undeniable but it is the way business groups treat their minority shareholders that signal the true practitioners of corporate governance in the country. This section also looks at the dividend policy as it relates to shareholder value, the interaction with foreign investors and the stakeholder view of the firm.
- Similar to other countries in East Asia, an ethnically-based minority, the Filipino-Chinese business groups, have provided most of the entrepreneurial zeal in the country over the last half century. However, this research concludes that identity, rather than ethnicity is more relevant amongst Filipino-Chinese business groups.
- The rise of China is awe-inspiring and could be advantageous to the economic growth of Philippines. As part of the Chinese supply chain, some Filipino business groups are expanding into this billion-strong market in anticipation of the opportunities the world's second largest economy provides. China's own

system of corporate governance is also discussed and contrasted with the Philippines. Ultimately, China's rise must be placed in the context of its wider geopolitical role in the region.

- Finally, the family values of the owners of business groups are discussed. Concerns common to business families such as succession planning and generational issues are explored and a case study of a family corporation in decline is related.

This chapter also provides evidence that proves my second hypothesis while disproving the third hypothesis in my research:

H2: Post-1997 corporate governance practices in the Philippines institutions and firms will not diverge from indigenous customs.

H3: Philippine firms that have adopted Anglo-American corporate governance practices are more likely to exhibit well-defined principal-agent relationships

The second hypothesis emphasises the importance of the pre-existing business conditions while the third hypothesis shows the inappropriateness and limitations of the dominant corporate governance theory of the firm - agency theory - in non-Anglo-American countries.

6.1 Dominance of Business Groups

Family-owned business groups are the dominant form of economic organisation in the Philippines:

“Most of the businesses in the Philippines are controlled by single family groups. This, of course, poses challenges to an effective overall corporate governance framework.” – private sector 1

Or more intimately as one put it

“...the company is the extension of the family” – private sector 2

Family-owned business groups in a weak and authoritarian state have the advantage over other forms of economic organising which supports Carney's hypothesis of business group development in the absence of a strong government:

“It’s a weak state – see Hutchcroft on the relationship between business and state. Hutchcroft’s book is set in the banking context. The role of the families, eventhough you can talk about the problems of corruption, there is also the history of some in the private sector with intent to strengthen themselves at the expense of the public.” – academic

“The advantage [of family corporations] is quick decisions are made faster. The view is long term and not short-term decisions. There is closer coordination with exceptions...In the Asian culture, if you look at which are the successful entities, most of the successful ones are family-owned corporations. They decide fast, they look long-term. If you’re [not family run], you tend to look on the short-term. If you’re a family corporation, you look in 5 years’, 10 years’ time. You can’t compare developed countries and developing countries.” – private sector 3

Thus, in this work, the umbrella term ‘business groups’ cover other colloquialisms such as family corporations (FAMCORs) and commercial industrial groups (CIGs). Business groups in the Philippines are characterised by kinship ties with ownership dominated by one individual and/or one family. Some companies are dynastic business groups having been in the same family for generations, while others are new entrepreneurs. The phenomenon of old money versus new money is not unfamiliar in the Philippines:

“The Sys founded and grew [their business]. This is the same with the Gokongweis. They started from below. The Ayalas have always been there for long, long time now. New players such as Andrew Tan, Lucio Tan, George Ty. Ty’s family wasn’t poor as he built from previous wealth, invested it and spin-off its growth. Jo Concepcion (RFM) was there after the war – a spin-off from a separate organisation.” – private sector 4

Business groups are the norm in the East Asian corporate landscape. This was observed by one of my interviewees:

“[The Philippine business groups is] not dissimilar to family corporate entities with the exception of Japan and Korea. Most of the region has companies where control is in one large company. [We] mimic models of publicly listed companies, when control blocks [are] put together (such as Hutchinson Whampoa Kai

Sheng), the Philippines is no exception – the Ayalas, SMC. What is underlying [this] is the ability of families to recognise these developments.” – private sector 5

The following table from Forbes Asia shows the richest 25 individuals/families in the country with their business interests and/or affiliations:

Table 27: Top 25 Richest Individuals/Families in the Philippines in 2009 (Forbes 2009)

Rank	Name	Business Group Affiliation / Interests	Net Worth (USDM)
1	Henry Sy	SM Investment Corporation	3800
2	Lucio Tan	PNB, PAL, Asia Brewery	1700
3	Jaime Zobel de Ayala	Ayala Corporation	1200
4	Andrew Tan	Alliance Global Group, Megaworld	850
5	John Gokongwei	JG Summit	720
6	Tony Tan Caktiong	Jollibee Foods	710
7	Eduardo Cojuangco Jr	San Miguel Brewery	660
8	Enrique Razon Jr	Container Terminal Services	620
9	Manuel Villar	Vista Land; Philippine Senate President	530
10	George Ty	Metrobank	515
11	Emilio Yap	Philtrust Bank	510
12	Iñigo & Mercedes Zobel	Mermac	440
13	Beatrice Campos	Unilab	410
14	Vivian Que Azcona	Mercury Drug	390
15	Oscar Lopez	Lopez Group	350
16	Andrew Gotianun	FillInvest Development	310
17	David Consunjai	DMCI Holdings	300
18	Robert Coyiuto Jr	Oriental Petroleum and Minerals	290
19	Alfonso Yuchengco	Yuchengco Group of Companies	230
20	Mariano Tan	Unilab	180
21	Menardo Jimenez	GMA Network	160
22	Gilberto M. Duavit	GMA Network	159
23	Felipe Gozon	GMA Network	135
24	Jon Ramon Aboitiz	Aboitiz Equity Ventures	125
25	Betty Ang	Monde Nissin	120

Furthermore, business groups in the Philippines have filled the institutional void normally reserved for government. A weak government with a limited amount of resources which does not have the efficiency to apply them to its utmost effectiveness does not have the capability to fulfil all its institutional and infrastructure obligations (see Carney 2008: 598).

In Manila, business groups have visibly filled this institutional void in the infrastructure

area with the development of the central business districts of Makati and Mandaluyong. Indeed, several comments were made to me during my fieldwork compared and contrasted how the landowners developed these two business districts with minimal contribution from the state.

However, while they fulfil part of the institutional void, business groups themselves are not substitutes for government nor do they wish to be substitutes for government. I would often hear comments such as “We are doing what government is supposed to be doing. This is supposed to be their job, not ours.” Business groups and their owning families - at least the ones I interviewed – showed little desire to rule the country even though their economic interests rival that of the state.

6.1.1 Downsides to this Dominance

There is a downside to the dominance of business groups in the Philippines. The private sector is an uneven playing field between affiliated companies and unaffiliated companies overlooked by government which enforces rules and regulations haphazardly and inconsistently:

“Certainly there is an uneven playing field. It remains a serious problem. This family-based form of economic power translates into familial politics. It’s an issue of control that’s why the stock market hasn’t developed. There are conglomerate problems: walls dividing various aspects of investment and banking are not followed.” –academic 1

The domination of business groups also deters continuous investment and deters competition:

“Most companies are owned by families, there is limited liquidity.” – private sector 1

“There is no way to do business [in the Philippines] without working with a business family. Look at Metrobank. Schools and colleges are owned by families – other than the religious orders. There is no sector in this economy that is not dominated by a family business. It makes us difficult to move, to grow. [Their] size makes you work with family networks and connections.” –academic 2

For foreign entrants, if they have not been deterred by the ownership restrictions, they face an uphill challenge to enter sectors which are dominated by certain business groups:

“The top oligarchies here of which there are 12 organisations are diverse in their holdings, so for a large foreign group to challenge that, it’d be difficult.” – consultant

Affiliating and allying with a business group allows them a foot in the door. Indeed, that was an advice given to me at a chamber of commerce meeting on how to successfully operate in the country. The business groups are reflective of the oligarchic nature of the country:

“People who affect the life of the country (political intellectual circle) is very limited. Elitist.” – private sector 2

Internally, a business group structure of inter-affiliated companies fosters a culture of insider information:

“Guys who own company have superior information. The owners are insiders – unlike in the USA where the insiders are managers. [You need to] increase the right information provided to make an informed judgement and not be taken for a ride.” – private sector 3

Business group structures may facilitate opacity which makes it difficult for the capital market to function efficiently.

6.2 A Matter of Ownership: Inapplicability of Agency Theory

Business groups which make up the majority of the real private sector of the Philippines still resolutely hold and control the power in their companies. In Anglo-American corporate governance, a major shareholder or blockholder is considered to be one who owns around 5% of total ownership. In the Philippines, a 5% ownership is considered a very minor stake. Most groups would have a major shareholder that would own at least over 50% of the company. Control is in the majority:

“To balance the major shareholder’s interests of shareholder intent is realistic – it’s human nature. Agency corporate governance issues here are different. It is important in the US [the] the principal-agent problem. There’s no agency

problem here. There's no situation here where the biggest shareholder owns 5%. It doesn't happen. There's a controlling shareholder, a block ownership and minority shareholders." – economist

Most of my interviewees spoke about the major owners and the percentage of ownership they have. Seen from an Anglo-American context, the extent of their control is staggering:

"The dominant family is the Montinolos. They have 40% ownership of the shares; the next is the SM Corporation (Henry Sy) which has 24%. There are foreign investors and although they would like to invest in FEU there are not many shares available." – FEU

"We have two main shareholder groups: Hong-Kong based First Pacific (private investment group) and Japan's NTT Comm (landline) and Docomo (wireless) NTT representatives are here as well with NTT within advisers within the company in an advisory capacity. Our notable shareholders are Philippine Telecoms, Metro Pacific, SSS, NTT Comm, NTT Docomo, and JP Morgan." – PLDT

"Ayala Corporation is 51% owned by the holding company of the Ayala Family named Mermac. 10% owned by Mitsubishi. The rest is owned by the public. There are foreign investors: 20% of outstanding shares, around 15-20%" – Ayala

"[T]here are two major shareholders at 40% each and the remaining 20% is widely distributed among individuals, firms, Filipino or foreign." – Petron

As one pointed out, having big blocks mean a great deal of control and influence is exercised:

"Once you get that size, a shareholder block of around 35% the block is still in control due to the sheer amount of money involved. We are still a relatively small company so if we list at all the number of shareholders will be spread out. One shareholder has a 20% ownership but there isn't one shareholder that has control. They are all buddies. We're generating money on our ROI." – unlisted company

In the Philippines, the Anglo-American corporate governance problem between

principal-agent is rarely an issue. Based on the ownership structure of Philippine companies, hypothesis 3 is disproven:

H3: Philippine firms that have adopted Anglo-American corporate governance practices are more likely to exhibit well-defined principal-agent relationships

Agency theory can only be applied in companies and countries where there is widely dispersed ownership, not concentrated ones.

6.3 The Holding Company

Astride the largest Philippine business groups is the holding company. The holding company is the apex of control as it represents the family's ownership interests in a corporate structure. Justifying this corporate form in a developing country, Wright quotes Ayala CEO Zobel on this use:

“The issues with respect to conglomerates have been argued about at academic and investment levels, and there are many valid arguments on both sides...We [in the holding company] have a slight tinge of the merchant banks of old who provided capital and management in emerging markets settings globally.” –Zobel in Wright (2006:26-28)

The holding company would normally contain the smallest number of employees in a business group structure. Below are two comments from one small holding company and the more substantial holding company of the Ayala group.

“There are 18 employees here. It is a holding company so it's a skeleton staff...almost like a shelf company. We have subsidiaries including one which has 200+ employees. We own 60% of it.” –small business group

“Ayala Corporation (AC) the holding company has around 100 employees. In 1998, we had an early retirement program and farmed out services to subsidiaries or outside companies. In Manila Water, there are around 3,000 employees. In BPI around 5,000; at Globe: 3000... Integrated has around 15,000 mostly based at Laguna Technology Park with operations in Singapore, California and China.” – AC

The importance of the holding company for business groups is that they do provide the overall strategic guidance over the rest of the group:

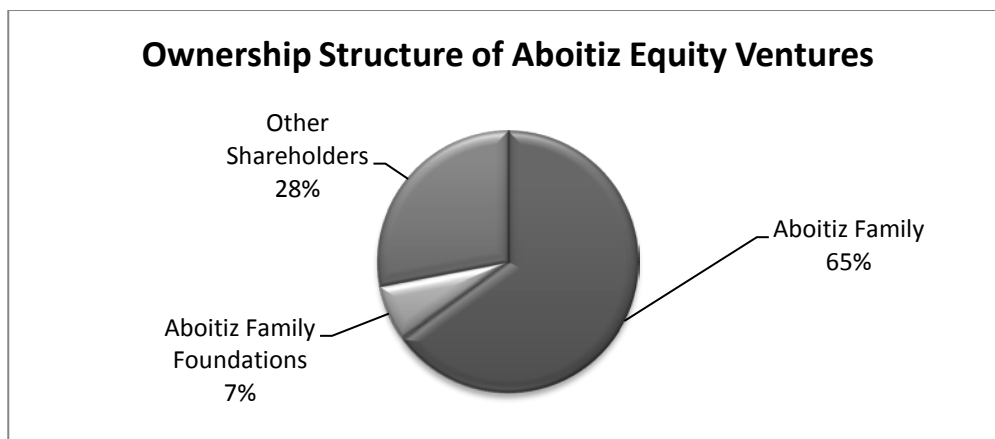
“Yes [the holding company] does [provide strategic guidance]. The general guidelines are formulated at the listed [holding] company. This is translated to each operating company. We do get guidance from them. The overall direction is directed by them.” – company subsidiary interviewee

Where the holding company is listed, the controlling family would have majority control through various related entities. Below is comment from Aboitiz Equity Ventures, the holding company of the Aboitiz Group explaining their ownership structure:

“Approximately 65% of Aboitiz Equity Ventures (AEV) is owned by the family. About 7% is owned by two foundations controlled by the Aboitiz Family. The balance is widely dispersed. We have over 10,000 stockholders, including various foreign institutional investors.” – AEV

The following figure contains the ownership structure of the Aboitiz holding company:

Figure 25: Ownership Structure of a Listed Holding Company



For the Lopez Family, the listed holding company is majority owned by a Lopez investment vehicle, BenPres, which in turn is 100% owned by the family:

“As of May 8, 2007, Lopez, Inc. owns 55.31% of BenPres outstanding shares. Lopez, Inc. is owned by holding companies which are 100% owned by the Lopez Family.” -BenPres

The following table contains the top ten shareholders of the Lopez holding company:

Table 28: The Top 10 Shareholders of BenPres as of March 31, 2007

Top Shareholders	Names	No. of Shares	%
1	Lopez, Inc.	2,533,012,402	55.29
2	PCD Nominee Corp.	992,582,424	21.66
3	PCD Nominee Corp.	720,123,760	15.72
4	Paul Gerard B. Del Rosario	104,467,000	2.28
5	Manuel M. Lopez &/or Ma. Teresa Lopez	10,985,000	0.24
6	Oscar M. Lopez	8,597,182	0.19
7	Lucio Yan	7,450,000	0.16
8	Siao Tick Chong	7,128,500	0.16
9	Manuel M. Lopez	7,089,114	0.15
10	Alan L. Montelibano	6,629,604	0.14

For one unlisted company with multiple-owners, major blocks continue to dominate the holding company structure:

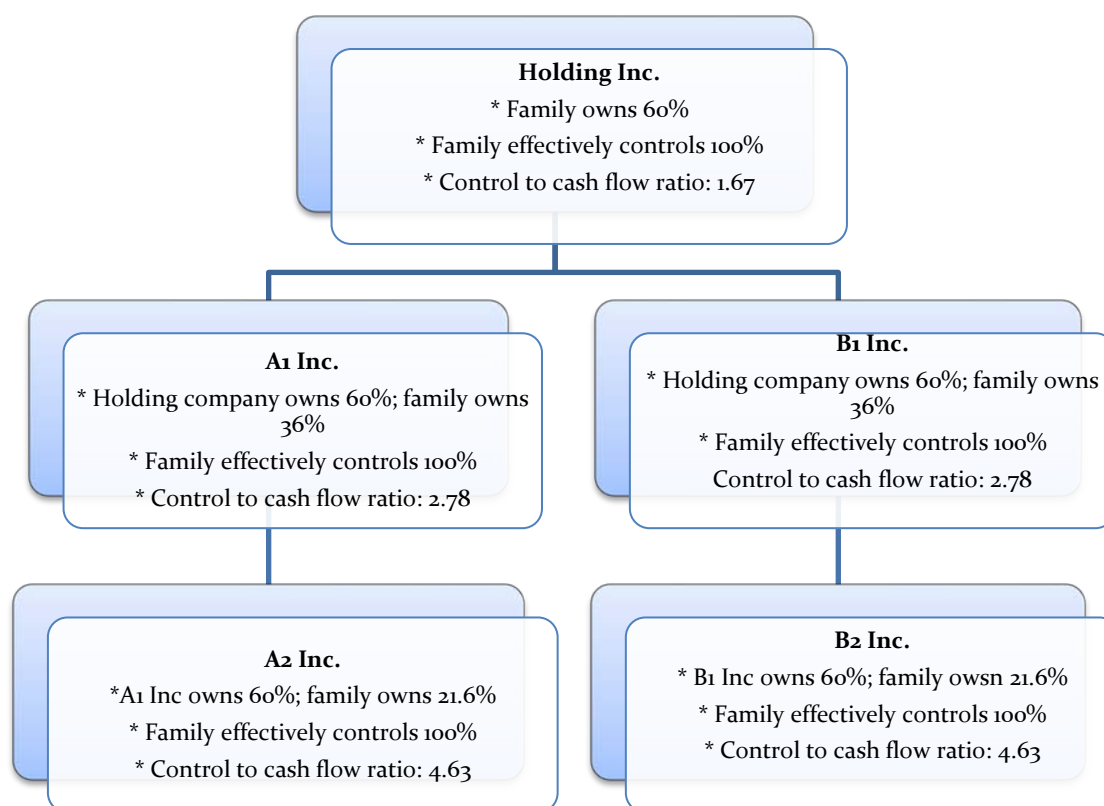
“In the holding company, there’s a significant corporation just under 40% that represents the owner. In the holding company each of these significant shareholders have various companies in the region. They haven’t listed anywhere – so its corporate governance standards are as private.” – private sector 1

The holding company plays a pivotal role in the Philippine business group structure.

6.3.1 Ownership Complexity: A Web of Companies

Having a web of companies or cross-shareholdings in the business group structure is also reflective of the volatility of the Philippine political environment. The effective control through this type of ownership can be seen in the following figure:

Figure 26: Hypothetical Structure of Effective Control in Cross-Shareholdings
(Dumlao 2006: 40)⁴⁴



The explanation of this figure follows, pointing out how through an intricate ownership structure, control of a company by a dominant player can be achieved even if the player does not own a majority ownership of the business:

“Consider a family that owns 60% of a holding company named Holding Inc. The rest, 40%, the investing public owns. But since 60% ownership is majority, the family effectively controls 100% of Holding Inc. Thus the family’s control to cash flow ratio is 100% to 60% ownership or $100\%/60\% = 1.67$

“Suppose Holding Inc owns 60% of A1 Inc. Since the family owns only 60% of Holding inc., the family owns 60% of 60% of A1 Inc. or 36%. The rest, 64%, the invest public owns. But since 60% ownership of Holding inc., is majority, Holding Inc. effectively controls 100% of A1 Inc. Since the family effectively controls 100% of A1 Inc. Thus, the family’s control to cash flow ratio is 100% control to 36% ownership or $100\%/36\% = 2.78$

⁴⁴ Dumlao, Luis (2006) Economic Assessment of Corporate Governance, *Loyola Schools Review*, 5: 31-64

“Suppose A1 Inc. owns 60% of A2 Inc. Since the family owns 60% of Holding Inc., and Holding inc owns 60% of A1 Inc., the family owns 60% of 60% of 60% of A2 Inc., or 21.6%. The rest, 78.4% the investing public owns. But since 60% ownership of A1 Inc is majority, A1 Inc effectively controls 100% of A2 Inc. Since the family effectively controls 100% of A1 Inc., the family effectively controls 100% of A2 Inc. Thus the family’s control to cash flow ratio is 100% control to 21.6% ownership or $100\%/21.6\% = 4.63$

“A similar story goes if A2 Inc. has a majority control of other companies. Even if the family has little ownership of a certain company, it controls 100% of the firm. Even if the investing public owns an overwhelming majority of a company, it has no control of the firm. The same story goes for the right side of the figure, B1 Inc., B2 Inc and so on. If the family controls all these companies, these companies will behave consistently with the best interest of the family...But this is not necessarily in the best interest of the investing public.” (Dumlao 2006: 39-41)

The family’s holding company may own a majority stake in one company; in turn this company owns a majority stake in another company; however the effective ownership of the family’s holding company is less than the majority and may be a minority stake – however the effective control rests with the holding company:

“This is a web of businesses, of companies. Ayala Corporation can be 49% owned by the public but 51% still owned by Mermac. Mermac is 100% controlled by the family. Another example is the Cojuangco Group of Companies with the sugar mill company. There’s a company in Negros. The majority, the biggest owner has less than 5% ownership of the company but up to 60% of ownership is scattered 1% or 2% stakes - all belong to the Cojuangcos, they have worked at this...More like dummy companies controlled by 1 or 2 people.” – commentator

Such transactions are widely covered by the media. The effects of an intricate cross-shareholding benefiting the holding company are encapsulated in criticisms of the control structure of several companies including that of the electrical company Meralco. The political connections of the owning family and the resultant higher power costs for the consumer exemplify how business is done in the country. Meralco was explicitly criticised by one interviewee

“...the culture of rent seeking is to capture politicians - to capture the decision making so you're not accountable. For example, with the case of Meralco – it's owned by the Lopez Family. That's why we have high power costs. The Lopez Family only owns 18% of the company and the government owns more. So what do they do? Through their power company, they purchase at a higher rate and sell it back to Meralco. There is no good governance there. The Lopez Family has a minority listed company but what they're doing is to the detriment of government, consumers and shareholders. The oligarchies here are above the law in a weak state. They own the politicians.” –private sector 1

Such a web of shareholdings was a contributing factor to the collapse of the Italian dairy company Parmalat owned by the Tanzi Family (Clarke 2007); while in the wake of the East Asian Crisis, Korean business groups, known as *chaebols* were pressured to reform for eventual dismantling of these corporate complex structures (See Chung 2005 and Li et al 2006):

“In Korea, it was like that before, now they have disallowed it. They forbid cross-ownership for small companies, but not on listed ones. They haven't adapted it more here. You just need to look at Parmalat.” – academic

The application of this intricate web with varying degrees of ownership ensures control across entities does query the form of corporate governance in the country:

“Family-owned corporations (FOC) are so dominant in the country as in many countries in Europe. One thing I've observed is companies in these countries with greater concentration ownership have poorer corporate governance. There are specific corporate governance processes of protection of minority shareholders. Is management competent? There are layers and layers of ownership. The main family have minority ownership but has 100% of control. It's a problem of control to ownership ratio.” – academic

Does such a structure hinder the implementation of good corporate governance and effective functioning of corporations? Intricate ownership complexity is not directly causal, but may facilitate for poor corporate governance:

“The million dollar question is how do you address it? It is not as if the case in the Philippines [is unique but] other countries have [this as well]. For some

reason here, there's a trend, those who are controlled by families have poorer corporate governance. This structure allows for poor corporate governance. But having this structure doesn't mean poor corporate governance but allows poor corporate governance. Just like [trade] liberalisation allows financial stability, some realise you have to stop liberalisation for stability – the stability to be poor or stably rich. [Ownership complexity] only allows [poor corporate governance] but doesn't cause it. It's not only a Filipino phenomenon. ” – academic

Another perspective behind this ownership complexity takes the political perspective. Does the political- environment of the Philippines make this type of ownership structure an effective buffer against a predatory state? Is ownership complexity an economic justification of protecting one's assets?

The Lopez Family, for example, became a vocal opponent under dictator Marcos' reign. Consequently, the Lopez Family paid for this dissent and their companies under the Marcos regime were expropriated and assets transferred to cronies of Marcos. It was only after the dictatorship fell were long (and sometime protracted) formal proceedings undertaken to have these assets formally transferred back to the Lopez Group. The Lopez Family also had the support of President Corazon Aquino which allowed the family to “to reacquire a substantial portion of their original assets” as a form of natural justice in the wake of the Marcos years (Lopez & Gonzalez 2001: 118). As one interviewee pointed out, the resilience of business groups and their structure has been shaped by surviving the tumultuous political environment of the Philippines:

“The Ayalas, the Aboitizes, they are better governed. They anticipated the [East Asian] crisis and worked well during and after it. The Ayalas, they survived two World Wars and Martial Law. You don't do it ad-lib; you do good management and corporate governance.” – corporate governance advocate

The next section is a commentary and examines the dark period of the dictatorship when some business groups were targeted by Marcos and his cronies. For some business families, their expropriated assets under Marcos were never recovered after his departure.

6.4 Business Groups and the Predatory State –Effects of Marcos' Dictatorship

“Hostile environments create a situation where individual entrepreneurs face significant moral dilemmas. They can either comply with the law, thus forfeiting the success of their businesses and their own economic well-being, or they can attempt to work within the context of a corrupt system in order to survive. Most choose survival.” (Dyer and Mortensen 2005: 253)

The years of the Marcos dictatorship still loom largely in the minds and hearts of the business elite of the Philippines. Those long years were turbulent, unsatisfactory and uncertain for the private sector.

For some interviewees, they saw the early years of Marcos' ruling as an opportunity lost. In those early days, people obeyed, did what they were told under his rule and the 'what if' possibility that certain choices in economic development could have been made and applied. For others, they see their fellow Filipinos as an undisciplined lot, where family reign supreme because there is a lack of trust in the main arms of civil society such as the judiciary, the government, the police and other arms of government. Therefore, in the absence of trust in the techno-bureaucratic elite, the family reigns supreme because families are the underwriters of last resort: economically, emotionally, and psychologically.

The opportunities were lost as absolute power absolutely corrupted Marcos regime. Striking fear into people's hearts can only last for a brief period of time and as history has shown, dictatorships are a rather unstable form of governing.

In this sense, when talking about the Marcos years, there was some ambivalence amongst interviewees. Some yearned for a 'powerful' figure such as Singapore's Lee Kwan Yew who turned a pirate-infested ridden island into one of the most successful island economies of East Asia in the latter half of the 20th Century. However, none doubted that Marcos' benign power became malignant.

Instead of Lee Kwan Yew, or pro-business dictators such as Francisco Franco or even Augusto Pinochet, the Philippines was saddled with a Robert Mugabe – whose early years brought so much promise (and perhaps hope) but whose lengthy rule oversaw a fecund and fertile land turn into a desert of ill-health and oppressive, grinding poverty.

Under Marcos' rule, selected favourites and cronies, received rewards. In some cases, whole companies were seized and transferred to favoured Marcos cronies.

At the nadir of Marcos' rule, there were few business groups that did not feel the effects of his avarice. Should Marcos turn his eye on a select group of companies, it became a game of cat and mouse: a politically risky strategy of ensuring the control of your companies without offending the political ruler of the country. This game was almost always to the detriment of the business groups critical of the regime.

6.4.1 Managing Political Risk

However, anecdotal evidence suggested that one strategy to offset the interest of Marcos in a business group was to invite foreign ownership in a company. Marcos' power was limited by the natural borders of the Philippines - he was a dictator of disparate islands. Should a business group have a major foreign investor present in its companies, it would be to Marcos' detriment to seriously offend another foreign government if he decided to expropriate the assets of a foreigner whose political masters were bigger and mightier - economically, politically and militarily - than an archipelago on the western coast of the Pacific.

Managing this political risk has been applied before in corporate history with varying degrees of success. In Mitterrand France, the presidential decree of nationalising strategic sectors and companies was met with fear, loathing and futile acceptance. Making overtures to a foreign investor to mitigate government expropriation is not an uncommon business strategy. Indeed one French bank invited the "U.S. Treasury to threaten France with retaliation if the takeover went through. The Treasury refused." (Byron, 1981)⁴⁵ Unintended consequences emerge when the lines between political and business risks intersect.

⁴⁵ This 1980s strategy had ramifications for another business twenty years on. For the French cosmetics company L'Oreal - in anticipation of the Mitterrand regime - invited the Swiss multinational Nestlé to take an ownership stake in the company in 1974. This fear proved to be unfounded as Mitterrand did not seize the company nor saw the fashion sector as strategic enough. Nevertheless, Nestlé's ongoing ownership stake in the company through the decades means that in light of the global financial crisis and family disputes of the L'Oreal owners, the Swiss conglomerate is being touted as a potential buyer of the French company. (The Economist 2009a)

6.4.2 The Legacy of the Dictatorship

The legacy of Marcos continues to loom large in the Philippines and the shadows of his rule continue to reign over the Philippines. In the Philippines, a majority ownership rarely goes below 50% because of the fear and loss of ownership and control. The psychological effects of the dictatorship cannot be underestimated. Understanding the rule of the dictatorship is a start to appreciating why business functions thus - in a highly complicated web but necessary way - in the country:

“[There is a] risk expropriated by the minority – a golden share. If I happen to be a powerful local investor whether government or not, I have the golden share – powerful to do what or not [and it doesn’t matter how much percentage of control you have.]” – private sector 1

“If there is a presence of a significant shareholder on the board - what would they do, for example, expropriate and other certain issues. ⁴⁶” – private sector 2

Like various figures throughout history where power is concentrated in one person and in one office, Marcos' dispensation of favours was a corrupt process that poisoned the efficiency of commerce and hampered the country's economic development. The possibility of a repeat of another dictatorship is not a remote possibility amongst owners of business groups. The attitude to the government can be encapsulated in a great mistrust towards the national government.

The national government under the direction of the executive is capable of expropriation (see Chapter 9: Corruption). Expropriation breeds insecurity and uncertainty in a business environment. This political risk is not far from the minds of the private sector as this is a high political risk that can be unmanageable and unmitigated in a country like the Philippines:

6.4.3 Makati Business Club⁴⁷

For the private sector, one legacy of the Marcos dictatorship was the realisation that an

⁴⁶ See Gulane (2007) which describes the Philippine government's notable stake in a company and exercising its right as a shareholder:

⁴⁷ Makati Business Club (2009) Home page <http://www.mbc.com.ph/> accessed 20 October 2009

independent voice needed to be established for business. Makati Business Club (MBC) was established in 1981 to provide a common outlet for the large business groups who were increasingly dissatisfied with the increasing oppression of the regime. Martial law had made a mockery of the country's democratic principles and placed its citizens under enormous insecurity. A state of siege had evolved where dissenting voices were suppressed. This period of time also saw businesses being seized by Marcos and transferred over to his cronies. A divide and conquer rule was implemented and for some businesses, it was more secure and safer to be co-opted by the regime than opposing it. Some members of the MBC flip-flopped their support to the dictatorship to the detriment of their reputation post-dictatorship.

When the regime fell, MBC fully supported the next presidential administration with the transition to democracy under the late President Corazon Aquino. To this day, MBC continues to lobby for less protectionism and more liberalisation and is strongly supportive of presidential administrations that implement reforms that open up the economy as the country has been hobbled by protectionism. (Rushford 2009) This has made the Club unpopular with other presidential administrations that do not support greater liberalisation. Hence MBC was supportive of the reforms by President Ramos and less so of Presidents Estrada and Macapagal-Arroyo. The other notable business lobby group, the Philippine Chamber of Commerce and Industry (PCCI) takes a less active approach as its membership base is 85% comprised of SMEs and therefore cannot be as vocal or independent-minded. Aside from economic reform lobbying, activities of MBC include CSR projects, Congresswatch and the Coalition Against Corruption. The MBC represents nearly 800 CEOs and senior executives. Membership to MBC is by institution with individual representatives nominated to the Club.

6.4.4 Contribution to Resource Theories

In a highly politicised, unstable and economically corrupt environment, trust reigns supreme. Companies that were strongly perceived as allied with the government administration, waxed and waned with the popularity of the administration and the policies that gave them an advantage (Bello 2005). The country still operates in a climate of paranoia. Who you can trust and depend on is the key to doing business in the country. Owners in the private sector rely on a coterie of insiders, who may not be

technically the most proficient but whose loyalty is undeniable. It is difficult for an outsider to assess why the Philippines has developed thus.

However, those who lived through the Marcos dictatorship can easily account for their fears and provides a strong reason why Philippine business culture can be insular. With dispersed ownership but effective control of several companies, a government intent on expropriating assets of the private sector will have to unravel the ownership structure of a business group before such a process may be completed. The complex ownership structure of Philippine business groups may ultimately reflect not only the absolute control-orientation of a majority shareholder, but also symptomatic of a defensive response to the uncertainties and vagaries of an unstable political-economic environment.

Precisely because the political risks are high in the Philippines that “diversified operations of kinship groups may actually facilitate development by compensating for the high levels of risk and the lack of organised markets that characterize preindustrial societies.” (Lamoreaux 1986) The evidence builds upon, and is consistent with, the resource-based view of the firm justifying the continued dominance of family business groups in unstable, developing economies (Guillen 2000), and the resource dependence theoretical perspective of organisations (Pfeffer and Salancik 1978).

Firms in developing countries expand not only to take advantage of their market dominance but also to mitigate the risk of expropriation by a predatory state. Conglomerates are large and complex so they have several jewels and crowns to survive in an unstable environment. In effect, should a fickle government come into power with the view of expropriating company assets, the business group is diversified enough to survive such a political move.⁴⁸ This perspective of the business group as bulwark against a predatory state builds upon the resource theoretical perspectives and also offers future explorations for research in the area.

6.5 Financing

The bank-based model of financing is the most common form of raising capital in the

⁴⁸ In 2007 there were moves by the President Commission on Good Governance (PCGG) to forfeit the assets of former Marcos crony, Lucio Tan who heads a complex conglomerate (Philippine Daily Inquirer Editorial 2007, Magno 2007)

country. Participating in the stock exchange to finance growth is still the domain of a few. This section looks at the importance of banks in a business group structure; the experience of listing; and the investment strategies of business groups.

6.5.1 The Banking Industry

The country's banking industry is fragmented, highly competitive and a growth sector. Remittances from Overseas Filipino Workers (OFWs) - which the country's economy is dependent upon - is allowing competition to flourish in the sector, is changing the country's banking practices to meet the OFW consumer segment, and is providing the strategic impetus for international expansion:

"Remittance flows were facilitated by easier access of overseas Filipinos to formal remittance channels....high level of remittances supported by increased presence of remittance agents abroad through establishment of overseas centres as well as tie-ups with other remittance companies and financial institutions abroad." - BSP Governor Tetangco in Lucas (2007)

"The OFW [phenomenon] means there is a remittance market. There are the banks but also other companies that thrive in the market. Western Union came here only a couple of years ago and is competing in the remittance market with the banks. The banks used to hold the [remittance] money for 15 days [before they released it]. Western Union and others have changed that." - private sector

"Metrobank has remittance offices in Singapore, USA, Hawaii, Canada, UK, Italy, Spain, Germany and Bahamas. Next to the Philippine National Bank, Metrobank is the biggest bank that handles remittances. We have 600 branches nationwide. For OFWs the service we provide makes it easier for the OFW's family, who for example lives in Ilocos. The OFW sends the remittance from the Middle East, and the family can immediately withdraw the money. We have six remittance offices in Hong Kong." - Metrobank

With 39 large commercial banks, the industry remains attractive for future acquisitions with active encouragement from the BSP to merge:

"China Bank is majority owned by the SM Group which includes the Sy Family. It has a significant shareholding of 31% however it is owned by the Dy Family. [It

wants to] be more aggressive. China Bank is a very old bank and Sy is interested in expanding. After the merger of BDO and Equitable PCI, SMI will have the second biggest bank in the Philippines after Metrobank and just ahead of BPI.

“Over the medium-term the BSP requires us to consolidate. This will encourage further consolidation as there are too many players in the industry. Banks are scale economies. BDO will consolidate with Equitable. China Bank is growing on its own. China Bank is interested in Manila Bank. Manila Bank has many branches. SM Investments has 2% and is the significant minority and BDO with 40%.” – SM

The banking industry in the Philippines is an attractive growth sector and is ripe for consolidation.

6.5.2 Business Groups and the Central Role of Banks

As mentioned briefly in Chapter 5, banks finance the private sector development of the country. Indeed, the large business groups have a bank in their portfolio of companies and this reinforces the insider nature of the Filipino business culture:

“In accessing capital, funding comes from banks owned by families and it still all about relationships.” – ICD

Arguably the bank is the most important entity in the group and a couple of interviewees supported Leff's (1978) thesis that in the absence of strong capital markets, bank-based financing is the best way to go:

“In the Philippines, a typical Commercial Industrial Group (CIG) would be owned by a family. At the core is the family, then the bank, then the other businesses of the group. At the centre of the industrial group is the bank owned by the family. A CIG exists because of weak capital markets. External finance is not through the capital market but sourced through the bank. Some 98% of external finance is sourced through the bank system, the rest - 2 or 3% is through the capital market (PSE). This is typical of a country where there is bank-based finance and a non-existent capital market with weak enforcement.” – private sector 1

“Most banks are under the control of family groups. [This hinders the] ability of

banks to finance development. The capital market in other countries finances development. Here, there is the comparative advantage of the big players. There is an exploitation of the small but numerous shareholders.” – CG workshop

For one group, the holding company invests in certain areas but needs the backing of different banks to finance its investments. This is a cornerstone of the bank-finance model:

“At the holding company we make certain investments. We don’t use internally generated funds. Banks are [the] important stakeholders for operations.” – private sector 2

Similarly echoed by another, both local and foreign banks are tapped to provide financing for the group beyond its own affiliated bank:

“As part of AC, the banks would occupy [our] high tier stakeholders. In the past and present, AC in all its undertaking, banks are important partners - both domestic and foreign banks. After the [East Asian] crisis, we couldn’t borrow locally as there were not enough funds and we were restricted by the BSP...In the case of AC, we can’t borrow unlimitedly from [the group-affiliated] BPI (Bank of the Philippine Islands). So we go to foreign borrowings. From 1995-1997, we resorted to USD borrowings from Citibank, Japanese Banks, BSP, and ANZ Bank (the latter providing a USD75M loan)”. – AC

Banks play a central role in the financing of the private sector due to the weak institutional environment of the country.

6.5.3 Bank Finance vs. Capital-Market Financing

The bank-based model of financing a transaction is generally straightforward. There are normally two parties involved: the lender and the borrower. The following figure is the simple transaction between the borrower and bank in this model:



Figure 27: The Bank Finance Model of Borrower and Lender

By contrast, the capital market requirements mean a complicated process must be undertaken involving and satisfying various stakeholders. In addition, a new level of disclosure must be made by the listing entity with several stakeholders that need to be satisfied. Below is a figure of the capital finance model and the various institutions and stakeholders that are involved in the capital market:

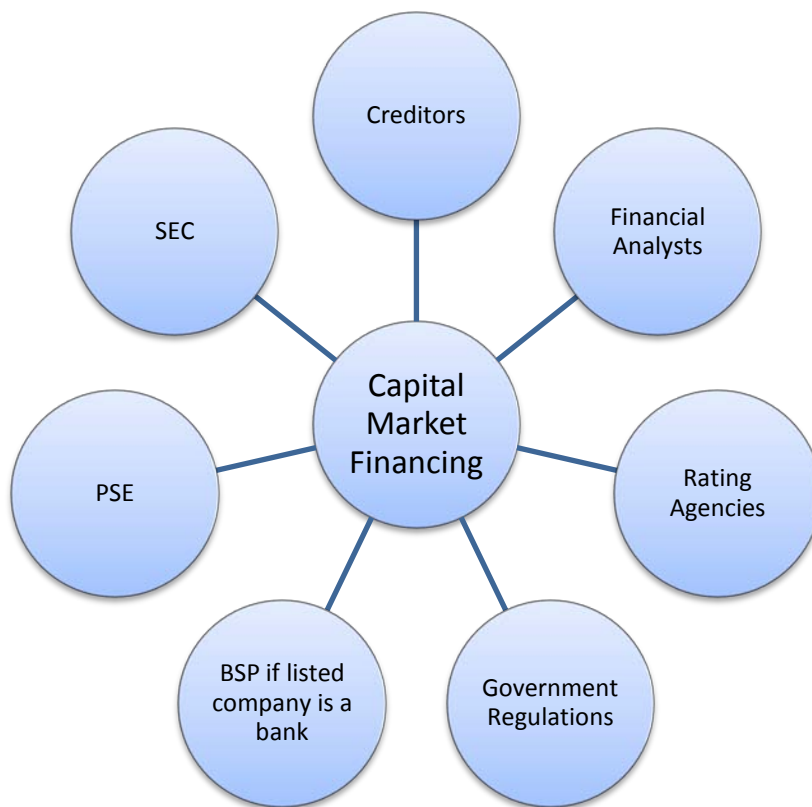


Figure 28: Capital Market Model of Financing with a Variety of Stakeholders

For a developing country like the Philippines, this complicated infrastructure is not ideal in an economy where several institutions underwriting the capital market are missing. According to one interviewee - an economist - the bank finance model is the easier way to finance:

“Banks are very dominant in the Philippines – around 80% of financing comes from the bank. This is the case in many developing countries. In the bank finance model, you only need a bank and borrower.” - economist

In the capital market model which is dominant in most developed countries, a higher sophisticated financial infrastructure must be in place for such a model to work efficiently:

“Capital market activity needs a PSE clearing system, payment system, rating system, financial analysts and so on. Essentially, what’s done by the bank as intermediation. The investor depends on several agencies – PSE, SEC, analysts. You need a high level of sophistication to have capital markets and higher levels of infrastructure.” – economist

The Philippines capital market is one of the smallest in the region. Third parties that can provide impartial information are still unreliable:

“There are peaks and troughs although it could be better; there are hardly analysts that cover us so the trading activity is limited on our shares.” – private sector 1

“However, at the end of the day, you can’t discount the credit agencies and investors who [rely on them to look] at corporate governance [of the company]. Corporate governance is an important decision making tool for them to invest.” – private sector 2

What the East Asian Crisis also highlighted was that regulatory institutions in the region were unprepared for the speed of the capital outflows that devastated the economies of the region:

“The crisis affected the stock market. For awhile, all stock market followed the downward trend with many of them in the Far East excluding Japan. Japan is in the big league. All stockmarket activity went down... It’s fine now. From July 2006 it has increased, gone better, we foresee a better shape of things to come.” – stockbroker

The crisis highlighted the downside to unfettered capitalism during periods of irrationality. The volatility of the capital market is an issue and reiteratively, the PSE may not reflect the economic situation of the country:

“[The PSE] is sentiment driven market at this stage. [It’s] not accurate, not on the street - whether the economy’s doing well or not. It’s likely to be cyclical.” – private sector 3

The 2007 bull-run on the PSE was deemed shallow by one regulator stating that foreign investment is fickle and this investment wavers at the slightest hint of political risk:

“The way of trying to raise money through the capital markets but what kind of depth is here? How much of an effect [does the market have on] everything? We may be lulled in believing we’re moving. We have perked up, there is an adrenalin rush [on the exchange] but how deep is that? How real is it? Hot money pulls out if there’s a [Presidential] impeachment filed.” – SEC

As a largely still developing stock exchange, capital market transactions which can swing from exuberance to fear can have a devastating impact on such a small stock market. As one interviewee pointed out, the East Asian crisis exposed the capital market model to countries so unprepared for its volatility:

“The East Asian Crisis proved that a system of non-transparency and lack of information system can make countries prone to shocks such as ours so that there are runs to exit. There were wild swings from exuberance to fear. Since then, is there a solidification or free flow of information so that there are no surprises? No, adjustments have been discreet. There is always a possibility of herding with the bulls running mindlessly. It will ring that way time and again and this will always happen with the capital markets.” – private sector 4

The ravages unregulated financial liberalisation can wreak on countries has prompted a debate on whether the capital market model of financing is appropriate and promoted in developing countries. World Bank Chief Economist Justin Lin states that the capital market model should be dissuaded in developing countries:

“Stockmarkets are unlikely to be a major force in poor countries in the near future. Microfinance companies and other non-bank financial institutions will play a more important role in financing poor households. And stockmarkets are not the best conduit for providing finance to the small- and medium-sized businesses that characterise the early stages of countries’ economic development. Instead, the banks will be much more critical when it comes to financing companies... Leave the developed markets to worry about how to reform their highly evolved financial systems.” -Lin (2009)

Therefore, Lin suggests that governments of these countries should promote the integrity and stability of their existing banking system to encourage entrepreneurs and promote greater private sector participation. He also suggests that failing banks be taken

over by other, more established banks. Underlying his argument is developing countries do not have the resources for the institutional infrastructure for complex financial transactions that capital markets require. Lin supports the position that in a developing country context, simplicity in financing rather than complexity is best suited to the majority of companies in the private sector.

6.5.4 Going to Market: Listing the Businesses

“I discovered a little truism: when you go public you get two things, money and trouble, and Cargill has enough of both, thank you.” – James Cargill of Cargill Incorporated⁴⁹ in Carlock (1994: 300)

For business groups that have evolved in size and complexity, tapping the capital market to meet their growing financing needs is an option some have exercised. The step of listing is a paradigm shift as the family business is taken to another level - opening up to outsiders. Listing for the largely family-owned business groups can be an emotionally charged decision.

Nevertheless for those business groups prepared to jump through the hoops, listing on the stock exchange has a profound effect on the company and its culture, and the financial rewards generally more than making up for the administrative obstacles.

For business families, listing can profoundly alter their relationship or attitude towards the business. The emotional attachment to the business when it goes public is remarkable. This section reflects the emotional issues of having publicly listed businesses, opening to the outside and riding the rollercoaster of going public.

6.5.4.1 Barriers to Listing

The business environment and family-related issues were the main barriers to listing according to my interviewees. One company mentioned the East Asian crisis postponed their listing and made them reassess which of their businesses should go public:

“SM was not ready. As a company it has always had corporate governance entrenched. SM Prime listed in 1994. Prior to that the founder Henry Sy had been strict in implementing formal corporate governance measures. There was a very

⁴⁹ Agribusiness and privately-owned giant Cargill Incorporated's website <http://www.cargill.com/> accessed 1 October 2009

strong risk and cost orientation. He takes his roots in the retail business in managing on cost and having a culture of not spending more [than necessary]. In 1994 SM Prime listed. In between 1994 (SM Prime) and 2005 (SMI), there were some planning. We thought of listing the retail arm. There were discussions of listing the property [company when] along came the 1997 crisis. There was no intention to delay but at the same time there was no urgency to list.” – SM Interviewee

Listing requires disclosure. For a privately held company that is thinking about listing, there is a shift in culture when the business is required to be transparent. The requirements for listing mean improving standards of disclosure especially in terms of material disclosure that could affect the share price of a company. Failing to disclose market sensitive information can trigger financial penalties. This is a big deterrent for some:

“When you list, you open your guts to the public. That’s a reason why some have preferred to take the backdoor route [where there is] no due diligence [required].” – stockbroker (1)

Attitudes towards transparency and disclosure may reflect the extent to which a company is still being family-run and not professionally-run. Indeed, the stock market takes a prejudiced view of unprofessionalised firms that have insider trading by owners. One family-run company sold corporate bonds instead of listing allowing the owners to maintain control over their business activities while allowing them to finance their expansion. However, once this company decided to list, the failure by its owners to be more transparent (such as not immediately disclosing share transactions by key executives) saw a valuation discount on their company share price.

For smaller companies, the main barrier to listing is the resource, time and cost of meeting the exchange’s requirements as there is much to attend to when a company lists. In general, smaller companies do not have the same resources or capacity as their larger counterparts to help them list:

“We’re getting there, if I’m looking to list in a few years’ time we are being prepared. While we’re not into formal planning, the intuitive we have [is to incorporate] corporate governance practice, [have a] strong financial position,

and be progressive from what has happened. We have much to cater to when we list.” – unlisted company 1

For another company, the financial costs related to listing and the PSE requirement to show three years of successive profitability were cited as the main deterrent:

“Our clients are global [but] we’re too small for listing overseas and it is very expensive to list overseas (I asked why they did not list overseas since the business derives most of its income offshore). We’re small and we don’t know their listing rules moreover we have had a loss. With the PSE listing you have to show three years of successive profits. If we list, we go through (a bureaucratic process). We would go on to the small board [on the PSE] so there is no reason to list now.” –unlisted company 2

Listing rewards but also demands. The capital market rewards companies that are transparent, and willing to share and offer information.

6.5.4.2 Motivations for Listing

The main motivation for listing is the financial rewards it brings:

“If we list, we’ll do it for growth and capitalisation reasons.” – unlisted company

Listing unlocks the market value of the company and finances investment. Listing allows the owners to reap the financial rewards and is the material evidence of their success:

“We were 500 times oversubscribed. There’s liquidity. The P/E is 12 – 14: 1” – listed company 1

For one company, the owner listed several assets and the capitalisation of his companies has placed him in an enviable dilemma:

“Alliance is owned by Andrew Tan (no relation to Lucio) – which is 20-25% partially listed. It’s worth P18B. He owns Megaworld, Emperador Brandy, and 49% of the local McDonalds franchise. He doesn’t know what to do with the money.” – private sector 1

The bull market of 2007 renewed confidence in the capital market and its strong run motivated a rush of IPOs as stock market turnover reached new highs:

“Our efforts to promote capital market growth continue to bear fruit.” – Jose Vitug, PSE in Bloomberg (2007)

For my interviewees, the stock market high of 2007 coincided with higher market capitalisation and volume for some of them:

“Our market cap/value has increased. [It’s to do with] timing. We used to be trading P2 to P3 but now it is P5.50. Double the increase in the number of shares, almost double the market price. The volume yesterday was 2.5M shares.” – listed company 2

The small stock market ensures listings are a momentous occasion not only for the company but also for the stock exchange. For the stock market to grow, new listings are necessary. In the Philippine context, successful listings that attract the majority of attention and investment are from established players that already have a reputational value prior to going public. In other words, most newly-listed companies are affiliated with business groups:

“There are few listing on the PSE, maybe they’re coming. Many companies are family-owned. There are giant changes when family-owned corporations list. SM Investment Corporation - so much of their stock is spread. The listed ones are big companies for the most part and a lot of stock is floating. The family domination, there is a lot of public ownership structuring for now for IPOs.” – stockbroker 1

For one business group, there was some discussion over which of their companies should be listed. Ultimately they decided to list the bigger company so that it would be included in the large company index rather than the small company index:

“In 2005, we were ready to list. In 2003, we were planning to list, doing work. We realised if we listed the retail arm we would be in the small caps. We wanted to go the big capitalisation index and so we did not list the retail.” – SM

The concept of nurturing a company internally before seeking external finance is a strong trait amongst my business group interviewees. This is also a reflection of the family’s own values as listing a company is strongly identified with the family. Only when the company is mature enough should it face the vagaries and sometimes brutal assessment of the capital market:

“The SM subsidiaries are developing, in the expansion stage and [we will decide] when it is the proper time for them to list.” – SM

For one company, the decision to go public was made after talking to several other business families about their listing experience. The following box relates this family’s listing journey:

Text Box 4: Listing - A Family's Journey

The account in this box shows the different motivations and factors that made one business family take the momentous step of listing and going partially public. The company was established some forty years ago, however it was only in the last decade that they had listed. There is a lengthy gap between the establishment of the business and listing. Why it took so long was due to a combination of factors. The main obstacles to listing were the external factor of the business environment and the internal factor of the family’s conservatism; the main drivers to list were the experience of other business families in listing and unlocking the market value of the company. The listed company is part of a business group. Like most companies, the major shareholder is a family. Overall the listing experience has been positive for the family. The following contains their journey of going public.

Business Environment

Reluctance to disclose information in a developing country environment and allowing competitors insight into the company was the main obstacle to listing for the family:

“Why it took so long? Well on the PSE, in the Philippines, there is a traditional base. Companies are usually selfish with financial records. We didn’t want to share our financial information – listing on the PSE means we have to share our information. We didn’t want our profits to be public. The business culture here is conservative, same with Indonesia, Malaysia...There were aspects of disclosures such as financial information, operating information – we were worried that our competitors could see what we are doing and planning to do. So that took getting used to that. It was one step at a time. ”

Capital Market Environment

The impression that the PSE had listed companies that were simply speculative compounded this impression and therefore the risk of listing outweighed the benefits:

“Before, there were cases on the PSE where companies would list shelf companies, such as oil exploration - using companies but there was nothing there.”

Family ‘s Fiscal Conservatism

Another obstacle was the family’s conservatism towards their fiscal position which eased the pressure to raise capital externally:

“One reason why we didn’t list earlier on was our conservatism. We were using internally generated funds to expand. We are very conservative. It was not me and other people’s money. We basically worked on economic growth, and borrowed little during the 80s and 90s. There was no pressure to raise debt to list. We pay short-term debts and we hardly borrow beyond a year.”

This comment echoes a discussion by Glen & Pinto (1994) on how companies choose debt or equity financing to expand and how listing has its pros and cons for businesses in emerging countries.

Experience of Other Families

However, seeing the example of others made the family sit up and take notice. When they spoke to other families who were taking their businesses public not only in the country but also in other countries in the region, the family started reconsidering about their objections to listing. This was an important factor – observing other business families' experience:

“It was very different to travel and compare business cultures in the region when the attitude towards remaining private started changing. The family felt it wanted to be more private about its successes. But then we started reading about listed companies and talking to people who have listed and listening to their experience.

“Most of the IPOs have happened in the last 15/16 years. Few companies went public, more so the family-owned companies. It took a number of decades, typically Filipino-Chinese companies. There was a change in the late 80s, and the IPO wave. One by one, [companies] started to go public. Prior to that was the Ayala Group. They listed their company. Then there were listing of other companies.

“In the 90s, there was the crisis; and then some companies went public. The Gokongweis, the Yuchengcos, [they are] strong [in] manufacturing, real estate. So we were not different from the others, so we had to go about [the process] at a deliberate pace.”

Financial Motivation

After concluding that other families had a positive experience with going public, the family decided to list one asset and unlock the value of the company. The asset was considered as the weakest in the family's business portfolio. Today it is the most valuable asset by market value. The family is thinking of listing other assets though this step would be taken reluctantly as there is no financial pressure:

“[The listed company] was the smallest business arm of [the holding company]. It was a P200M business. We built it up through acquisitions, taking a twin-pronged approach. [Today, the listed asset] is now the biggest company in the group. It's a possibility, listing other companies of the group.”

Experience of Listing

Listing some managerial changes occur in the company:

“In 2000, we were ready. [The listing] required exposing more figures. The first year of listing was awkward as it required the exposure of the figures. Even the prospectus [was difficult]. The IPO listing was the first step to get the founding family get their feet wet and navigate as a public company. [A family member] was the first chairman but didn't enjoy it much, [so the non-family member professional] was Chair from 2002 onwards.”

Ownership and Control

To ensure the dominant control of the family, only a third of the company was listed. Similar to other business families, partial listing ensures and protects family control of the business. This is a common trait in family-owned listed companies. The following figure shows the ownership structure of the group and where the listed company fits in the business portfolio:

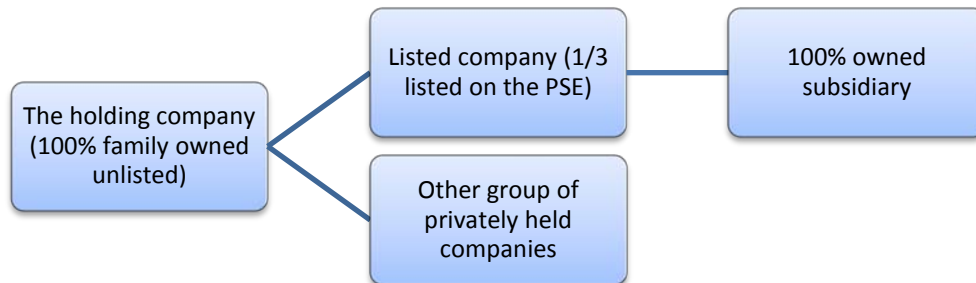


Figure 29: Ownership Structure and the Listed Company

“The 100% owned subsidiary is the listed company vehicle of the holding company which is the controlling shareholder of the company. The listed company has been acquiring affiliated companies over the last year. The family indirectly owns 2/3 of the company with 1/3 being publicly listed.”

To mitigate any potential blockholders, the family has also ensured that a third of the company in the public float is widely dispersed:

“The 1/3 public shareholders are fragmented. There is no single owner holding as much as 3%. We arranged it with the underwriters to have dispersed ownership. We have over 1,000 shareholders. It looks small...but there may be a lot more than 1000 shareholders. 20% on free float would be big investors with the PCD nominee accounts, stockbrokers, managed funds, trusts and financial institutions. Last year we offered to increase liquidity as trading volume decreased; so we reinjected liquidity in issue, risk capital for [our] strategy.”

Aftermath of listing

Overall, listing for the family has been a positive experience with the financial valuation exceeding expectations:

“The listing has been positive. In terms of unlocking shareholder value, the facts speak for themselves. 6 years ago the market value was USD12M, now it is USD180M.”

The whims of the capital market has also taught the family the importance of responding to investor demands and market conditions:

“We have had several years of experience now as a listed company. We have made it. We can show we have it on public: corporate governance, accounting. We adjusted fairly well. We are not actively looking at price targets, we don't live for our quarterly reports. If you are too obsessive with the quarterly reports, it would make you miss out on something. The focus on the business – if the share price goes down, we want to know the fundamentals that are driving down the price. That's why we're on roadshows to get the investor's perspective. [However], if the reason is a perception issue, we need to communicate better. We are on the periphery, so we're trying to get more analyst coverage.”

Although the reluctance to disclose publicly available information outside the regulatory requirements still lingers:

“In the last 6 years we’ve never had problems with non-disclosure. We sometimes pre-empt the PSE. We disclose immediately especially if there’s something in the newspapers which triggers a call or email. We try to be proactive. We still post our disclosures on the PSE website, but not on ours as the website is not fully developed. Before all these IPOs, there was the SEC Code which required disclosure. [There was a] natural reluctance to disclose because we’re going to niche markets and this points to our competitors where we’re going.”

Nevertheless, listing has given renewed confidence to the family and their relationship with the business:

“Our philosophy is to be fair to all shareholders. They worry the most if the value of the company depreciates. Over the last 6 years the managing/controlling shareholders significantly increased the value of the company. [We are] setting long-term growth plans though it’s early days yet. We’re doing it in a way in managing a business to be the best that we can. We have a strong penchant for the last 10 years of not borrowing too much. Our values reflect what we want to do.”

As the business moves from member-entrepreneurs to member-stewards, the core values of the family will determine the future direction of the company:

For one company, a rather unusual motivation to list was for local acceptance. As a company which had substantial foreign ownership, listing on the local bourse was a way to be accepted as a Filipino corporation. Another upside to listing – apart from achieving this perception and acceptance– was it also helped raise funding for the company:

“The company listed just before the [East Asian] crisis. Why did we list? We listed because of the 40:60 principle here in the Philippines. No foreign owner can own more than 40% of the company. The foreign ownership (40%) has always been difficult, we wanted to be seen – the perception thing – to be more of a Filipino company. The people saw us a foreign entity and the advice that we had was that if we wanted to appear more Filipino then we ought to list. So went through the process of listing. I know it sounds like a funny reason but the listing helped us raise funding as well though that was not the prime reason.” – listed company

For another which had substantial foreign ownership, demutualising on the PSE gave Manulife shareholder presence in the country:

“The advantages include an increased local presence and providing a local market for shareholders in the Philippines.” – Manulife

Listings will foster in an investment climate that is confident, encourages private sector development, and has a stable political environment.

6.5.4.3 Partial Listing

In most developed countries, when a company decides to take the plunge and go public, 100% of its ownership is listed and openly traded on the stock exchange. In the Philippines, it is common for companies to be partially listed – that is, only a part of the company is publicly listed and traded. Partial listings are the norm for Philippine corporations:

“Corporations usually publicly list only 20% of their own shares” – ICD

In the Philippines, the main reason behind partial marketisation of the ownership of the company is to ensure control remains with the majority shareholder. This is the norm in emerging markets (see Davis 2008: 139-140). In developed markets, partial listings are common in the privatisation of state owned companies. An example is Australia’s Telstra Corporation where a staggered listing of the company occurred over a decade. This had a tumultuous effect on the board membership of the company due to the director appointments nominated by its major shareholder, the Australian Government (Hewett 2009, Kohler 2004 and Brown 2004).

As the previous section’s box on “Listing – A Family’s Journey” related, the floated part of the listed company was designed to ensure there was widely dispersed ownership. This would prevent the formation of significant blockholders that could challenge the family’s ownership. Thus partial listings do come down to a matter of control for the major shareholders:

“The board will decide when the time comes to list. If [listing is] purely driven by capital requirements, [then a certain percentage] of the company will be listed – they (the owners) would wish to remain control. What the family wants.” – unlisted company

“If we have 50M shares; 10M, 20M are only listed in what is known as a free float. For example there is 100 shares of the company- 40 shares are listed, 10 of those

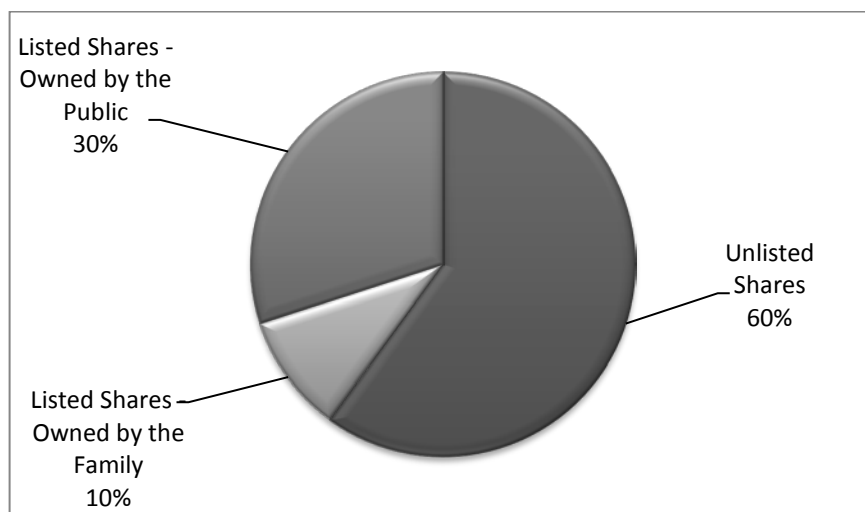
40 shares are the family's so they can trade. 60 are untraded and are unlisted - that is control remains with the company.” – listed company 1

Listing publicly means accessing capital or unlocking the wealth that could have remained untapped. At the same time, there is a certain ability to have one's cake and eating it too: listing publicly does not equate to losing control over the company

“On family ownership, it's been changing. You don't have to own 90%, you can sell to 51% and still control the company. Gokongweis have sold down its stake to retain the ownership. No more matter of co-borrowings. Robinsons, Robina – as long as he has control. He's unlocked the value in the company.” – stockbroker

The figure below depicts the explanation of partial listing which ensures that only a small portion of the company is publicly floated (40%) and publicly owned (30%)- so the family retains overall control (70%) of the company due to its overall ownership of listed and unlisted shares:

Figure 30: Shareholders of a Partially-Listed Company



The above figure is similar to Figure 25 which showed the ownership structure of the Aboitiz's listed holding company and how the majority ownership remains in the family.

In one interview, only 22% of the company was on the open market and the remaining stake remained with the family. For the company, there was reluctance to list but due to some minority investors within the business the major shareholder decided to go public to allow the minority investors to capitalise on their investment:

“There were certain businesses with minority investors so [the family] revisited the bid to go public. It was a question of valuation and controlling interests.”- listed company 2

The staggered listing also occurred for this company however the stakes remain small and limited:

“22% of the company is currently on float. The first IPO free-float amount was 20% then an additional 2% listing. There is a small minority group of investors. It is predominantly owned by the family with 78% belonging to their holding company.” – listed company 2

Even where a company is fully listed, there is a majority owner:

"All shares are listed. And it is at least 51% owned by the [family]. The ownership is divided between two brothers: We have 12,000 shareholders and nobody really owns a big chunk. The next would be 2% share belonging to [another family]. The only listed company is the holding company. All shares are listed, not partly listed. There are 2.5B shares available. 27% are foreign investors and they are all PCD nominees so we do not really know who the shareholders are as they buy through brokers.” – listed company 3

Partial listings are an effective ownership strategy by business groups to retain control of their listed companies.

6.5.4.4 Multiple Listings of Assets

Multiple listings of assets are common amongst diversified business groups in the Philippines, but not so in developed markets.

The conglomerate form is present in General Electric (2009) which has a variety of interests across different sectors. While it is a highly diversified business (whereas most firms are industry specific in the West), the listing is only of the one conglomerate. All arms of the business are assessed together under one umbrella and a market price is given. The Australian financial group, Macquarie Group (2009) has special investment vehicles for its different managed funds and these vehicles are then listed on the stock exchange with the controlling interest remaining in the parent company (Macquarie Group 2009). Macquarie probably best exemplifies a business group equivalent in an

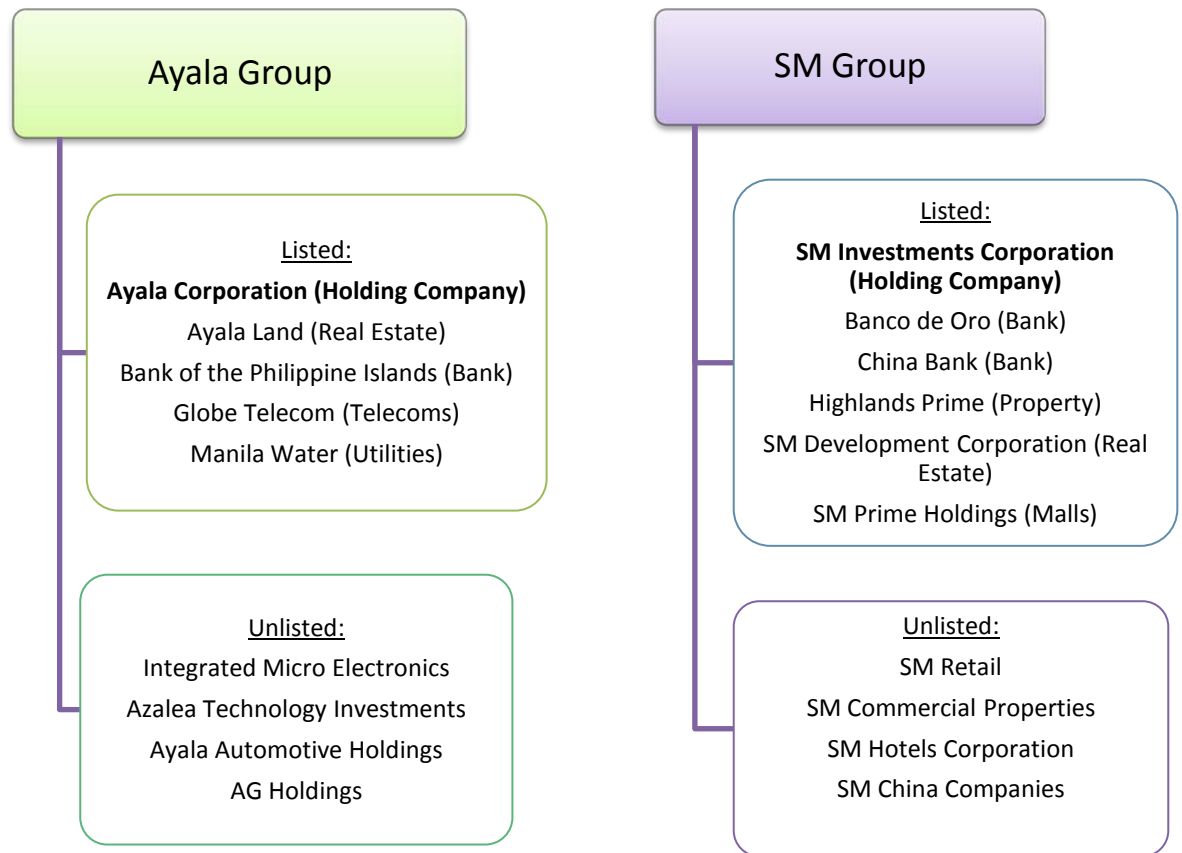
Anglo-American setting. Therefore, in the Anglo-American world, a listed parent company that spins off a related asset on the capital markets normally indicates that subsidiary has matured and can operate independently. Issues of strategy or divergent interests are catalysts for spinning off the entity. Such examples of these include the now-defunct Arthur Andersen and its consulting arm, Andersen Consulting now known as Accenture (2009); and BHP Billiton and a spin-off BlueScope Steel (2002).

In the Philippines, listed business groups tend to be in the mature phase of their life cycle. They privately build up their businesses before utilising the capital market to unlock the market value of their assets. Business groups list one business after another and not at the same time. For one business family, with a diverse set of holdings, only one asset is listed while others remain private:

“[The family is at] the cousin consortium stage – it’s an LLP (limited liability partnership). It’s 75 years old. They have one outfit that is publicly listed.” – private sector 1

Therefore, a business group’s portfolio has assets that are listed and others that remain private. The next figure compares the listed and unlisted subsidiaries of two leading business groups in the country: The Ayala Group (2009) and SM Group (2009)

Figure 31: Listed and Unlisted Subsidiaries of Two Filipino Business Groups in 2007



In the above figure, both holding companies of the two business groups are listed. Several questions arise in this form of conglomerate structure: Is the holding company considered the most valuable asset of a business group since ultimately it is the parent/manager of the assets? In terms of market valuation, what would be the investment decision justification for one listed asset that has industrial operations to be considered more valuable than the holding company given the subsidiary company is directed by the holding company? How does a market value operational, rather than management, capabilities as more attractive? The indecision on how to treat this conglomerate form was noted by one interviewee who stated the variabilities in valuation over the holding company and its other listed assets:

“We are fortunate to see that AC and its subsidiaries are the favourite picks of investors. For foreign investors, it’s been a dilemma to choose between AC and other companies. Previously, there was a shift to invest into the different subsidiaries, as all companies are making money before the benefits of good

performance were generated by AC. They sold AC shares to buy into the subsidiaries. This has now shifted lately with investment back to the holding company as AC has the capability of building good businesses.” – AC

One possible reason for this dilemma by foreign investors is their trepidation with complex business group structures such as pyramidal business groups which were negatively affected in the wake of the East Asian crisis. Exploring the role of the modern day East Asian listed holding company and its subsidiaries could be a worthwhile avenue for future research.

6.5.4.5 Related Party Transactions

This issue of interrelated and affiliated company transactions is one of the more problematic aspects of business group structures. Company-subsidary borrowing and lending is a reflection of two things 1) business groups in developing countries tend to finance growth internally 2) capital markets are weak and underdeveloped. The former is a substitute for the latter but it also creates distortions and in the context of increasing transparency in corporate governance, interrelated transactions remain problematic not only for the investors but for the owners themselves:

The more a company is transparent, the better rewarded it is by outsiders. Not surprisingly, valuations vary:

“In corporate governance, if you have that sort of blot in your history, such as by not being transparent, you get a valuation discount. This will affect your growth and P/E multiple. That blot in your reporting is a corporate governance issue, and the market will accordingly give you a discount on your share price. The market will give the valuation it thinks you deserve.” – stockbroker

Market values of business groups depend on how transparent they are to the financial markets by making timely disclosure:

“JJ Summit, the Gokongweis had an issue of intercompany borrowing. The parent was borrowing from the company subsidiary. The parent would borrow from the cash rich subsidiary, but the cash would be used for investments - using the funds of the subsidiaries for the parent. It didn't help the Gokongweis, there was that stigma. Unlike much more reputable companies such as Ayalas, PLDT, their

share price trade at higher multiples because they're clean, spotless." - stockbroker

The family did learn from this and bounced back; showing they were responsive, and in return the market was more receptive:

"..the Gokongweis – they came back following an offering in 2005. Prior to 2005 it was a difficult time – they were unloved because of corporate governance issues. Corporate governance is bigger now than before. Things have turned around. With a dead market who the hell cares - but in the last 3 years [it is a bull market and] a growth market." – stockbroker

There is also focus on related-party transactions in business conglomerates involving the channelling of funds from the unlocked value of listed assets to weakly performing unlisted assets. While listing helps unlock the market value of a business, ensuring the listed business is not exploited for the private arms of the group are an important assessment for outsiders:

"Another issue is the side business of the families. The side business can interfere with the listed company. It's a corporate governance risk if there is a significant interest with the side business, [as the family] could take money from the listed company for private interests (see Parmalat case), milking the listed company for the private business. So we usually ask, what other stocks do you own besides your listed company? It is part of getting to know the company: ask. Who are your side businesses?"-stockbroker

Unravelling the knot of related party transactions is not an issue that can be wallpapered over:

"When you're talking about principles of corporate governance, you have to be unpleasant. Related party transactions are not pleasant." – investment banker

while some follow corporate governance principles of transparency and timely disclosure, others do not:

"The family are the insiders. For example, there is a company problem with the operations and they don't publicise the information or not as timely as possible in their transparency/information. Maybe they have a labour dispute in Latin

America- obviously this would affect the sales and revenue. This would also affect the major operation and [they don't tell us how big the impact of this dispute is]. We ring up so they can usually provide more information. But by then it's usually too late. There's a leakage, there's a rumour, there's a problem. People are selling down. When news come out, it's not transparency. There's a saying here: "you buy on the rumour and sell on the fact" It's an old saying. It's an inefficient market." – stockbroker 2

Related party transactions do come down to the inefficiencies associated with the capital market in the Philippines, and depending on the largesse of companies dominated by family owners to govern well and fairly for all shareholders.

6.5.4.6 Overseas Listing

For local companies that have successfully listed on the PSE, another option for them is to list on an overseas exchange. Apart from the financial incentives, listing on an overseas exchange is a veritable challenge as it requires a higher compliance of disclosure. One interviewee pointed out listing overseas would test the mettle of the company:

"The overseas market is very challenging. If I'm a professional, [it would] test my capability. Just look at PLDT. Difficult in Singapore/NASDAQ in terms of the [amount of] information you provide. But once you walk through, it's easier to list within the time frame." – private sector 1

For the most international Filipino company on the PSE, the NYSE-listed telecoms company PLDT, overseas listing has meant a higher level of disclosure and transparency, and compliance with the Sarbanes-Oxley Act (SOX):

"The advantages [of listing overseas] are that you comply with higher corporate governance standards. The disadvantages are the costs of compliance. In light of SOX, compliance requirements are very costly, principally due to the intensiveness, the external auditors and time it consumes in regulatory compliance. The costs are very prohibitive. It entails lots of work to validate compliance requirements. The preparation for SOX compliance is because of s.404 with respect to the internal control processes under the Financial Reporting

Requirements. In s.404 all departments within the organisation have to revisit the processes with s.404.⁵⁰ - PLDT

The reportorial requirements under SOX have also seen a competition for listings. For PLDT which is dually listed on the PSE and NYSE, and whose parent company is listed on the Hong Kong exchange, the company needs to meet the different requirements of the different stock exchanges:

“If you look at developments in the USA, there are also the compliance requirements for listed companies and on the NASDAQ...There is competition due to regulatory compliance between the London Stock Exchange (LSE) and NYSE over the last 2 years. LSE has more listings than NYSE due to the reporting requirements of the latter. If you look at developments in Asia, the Hong Kong Stock Exchange (HKSE), the Singapore Stock Exchange – they have attracted foreign listings. Professor CK Low from the City University of Hong Kong said the HKSE has opened up listings to Filipino corporations. The parent company of PLDT is First Pacific which is listed on the HKSE. The parent company of PLDT is not a subsidiary but is amended to be a material affiliate to comply with Hong Kong financial requirements on internal control and risk management.”-PLDT

In addition, the widely dispersed ownership in Anglo-American settings means the investor audience is different to the Philippines:

“It is difficult to apply NYSE rules to the Asian setting. Stock ownership is not as diverse. No single individual or family own big chunks. In the Philippines it is either owned by families or owned by the state.” - PLDT

Foreign listing is not an easy undertaking however the rewards include having an international reputation and recognition that the company is practising corporate governance on a higher level. PLDT's corporate governance practice has placed the company at the vanguard:

“For us to compete, it's important to adapt to international corporate governance standards.” -PLDT

⁵⁰ Section 404 of the Sarbanes Oxley Act deals with a rigorous assessment of a company's internal control procedures. See IIA (2008).

For another group, a part of its banking company Banco De Oro (BDO) are listed on the London Stock Exchange in the form of global depository receipts (GDRs) to attract foreign investors:

“For 10% of BDO the listing on the LSE was just GDRs. There was an increased float for foreign investors and certain portion of shares were exchanged with GDRs.” – SM

The group chose the LSE because there is more market activity and was easier to underwrite for their investment bank:

“The GDRs are not actively traded. The [investors] like the merger [BDO and EPCI]. It’s strong. They’d hold on it that would limit the liquidity of the shares. We listed on the LSE, because according to Macquarie Bank, it was easier to underwrite the BDO listing on the LSE or Singapore than to list on the USA. They advised us it was a choice between Singapore and London. The transaction for the GDRs was more active in London so we listed BDO on London more for convenience.” – SMI

Nevertheless, critics of the global convergence of corporate governance standards may find some comfort that the requirements of each stock exchange ensures convergence will not be an administrative reality anytime soon.

6.5.5 Unlisted Companies

The Philippines still has a long way to go to have a fully-functioning capital market. The listed companies mentioned in this chapter are the exception rather than the rule:

“The PSE is a pretty small exchange in the overall scale. Again it comes back to the structure of the country – families that control the powerful companies which aren’t listed.” – private sector 1

Some large companies are still privately held while for some business groups, flagship companies and their profitable companies remain unlisted:

“The Ortigas Family-owned 4,000HA land north of Pasig. Where the Ayalas owned the southside and developed Makati, the Ortigas sold off parcels of land where the ADB is now. San Juan, Pasig, Mandaluyong is the Ortigas’. Unlike the

Ayalas, the Ortigas Family has not listed its flagship company.” –observation notes

While for the SM group, the jewel in their crown remains unlisted:

“The retail arm is unlisted. In terms of revenue it has the largest contribution.” – SM

Until there is enough trust and confidence in a well-functioning capital market, then moves towards this form of financing will remain the domain of a few.

6.5.6 Listing and Corporate Governance

Listing improves the corporate governance practices of companies as they are compelled to comply with the requirements set by the PSE and the SEC, and the BSP if they’re banks, or the IC if they’re insurance companies. There is a link between listing and improved corporate governance.

In listing, corporate governance in a company must be incorporated. This creates a better environment for business as fundamental standards and rules are set out for doing business. Complying with the corporate governance requirements has pressured companies to be more transparent in their practices:

“Corporate governance in the Philippines has come a long way. As more companies have taken the route of going public, this has forced these companies to be more transparent in their businesses.” – holding company 1

“It’s changing more and more. Companies are now realising corporate governance per se will come with additional costs but there is also the benefit of corporate governance. especially if you’re going to be bigger. Ultimately you have to go [outside] for funding and practise corporate governance as seen as in developed countries in order to get funding.” – holding company 2

For one company, corporate governance was one of the main motivations to list – to incorporate and improve the practice within the businesses:

“It was in May 2005 that SM Investments [the holding company] listed. It used to be privately held. Other subsidiaries such as SM Prime were listed in part. The

family was busy but it was expanding fast. There was no need for the public listing. There was not much need for fresh capital. The operations they've had were relatively liquid. But they wanted to go to the market to further expand the business. One of the most compelling reasons is corporate governance. Being a listed family group, they would have had better reasons to formalise corporate governance practice. They saw this happening in the SM Prime [listing] in mid-1990s [which formalised] corporate governance practice.” –SM

Listing and corporate governance go hand in hand in a mutually beneficial virtuous cycle:

“...[B]eing a publicly-listed company has had a very positive effect on corporate governance. We have no regrets at having taken the company public in 1994.” – holding company 3

Listing can improve private sector development in the country due to the meeting the standards the market requires and the discipline it imposes:

“Family firms have now the tendency of going public - that will help strengthen the private sector.” – listed firm

“We like the discipline imposed on us by the capital markets. We achieve this either through public listings, independent governance structures and financial transparency even in our non-listed investments.” – Ayala CEO in Arce-Dumlao (2009)

To list means a company has reached a modicum of professionalisation which can operate in a demanding capital market environment where disclosures must be made, and compliance to regulatory requirements. As one interviewee point it, due to the effort required, listing is the “external manifestation of corporate governance.”

6.6 Business Groups and Portfolio Investment Strategy

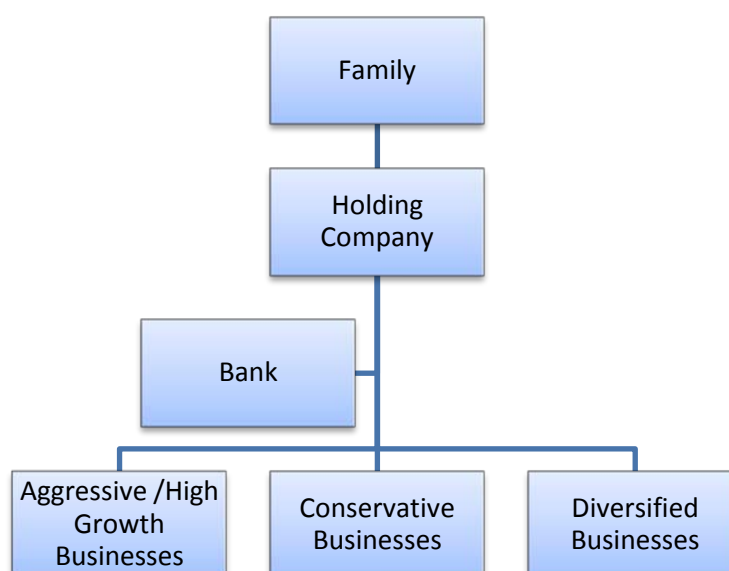
Once business groups sort out the best form of financing for their web of businesses, where and how to invest the capital they receive is a strategic challenge. The best way to conceptualise the investment strategy of a business group is akin to an investor who has different assets in different sectors but the assets are major vertically-integrated

businesses or companies across a variety of industries. Depending on the level and appetite for risk - as in any investment portfolio - a wide variety of assets are present across different industries. According to one interviewee, large business groups in the Philippines behave like a diversified investment portfolio with the holding company acting like the fund manager. Similarly with a business group, several companies that it owns may be classified as the aggressive/high growth entity, the conservative asset or the diversified business.

“For example, you have the Aggressive, Conservative, Diversified [classification of businesses]. The public who owns shares in these companies have no luxury of being conservative or aggressive. So when you’re diversifying companies, one company goes extreme [either aggressive or conservative]. The bigger entity behaves like a fund manager.” – academic interviewee

As opposed to Figure 31 which divides business group assets by listed and unlisted assets and is more useful for the investor, the following figure is the owning family/holding company perspective of the business group. The figure shows the business group as an investment portfolio with different businesses classified according to the level of risk appetite and growth strategy:

Figure 32: Business Group as an Investment Portfolio



Professional managers working in these companies must have a sense of awareness of

the investment strategy of the owning family/holding company so their sense of purpose in the business is tempered by this knowledge:

“If you have a host of these things, all executives have to comply with something bigger that is, one corporation is part of the greater good – it serves the wider family holding company interests. If you do what you’re supposed to do with intent of doing something bigger, you diversify.” – academic

A well-diversified portfolio spreads the assets and the risks. Business groups generally take such an approach with companies under their umbrella. The next section looks at how this approach is applied in the property sector of the country.

6.6.1 Competition in the Property Sector

Certain industrial sectors in the Philippines are protected in the country. However, where a sector is opened up to the private sector, entrepreneurial activity flourishes and competition is fierce. This is the case of the property sector in the Philippines. Business groups dominate this sector and competition in this profitable industry provides an insight into how groups compete against each other. One strategy applied by business groups is to establish several companies (owned by the same business group) to target the different markets and different consumer segments:

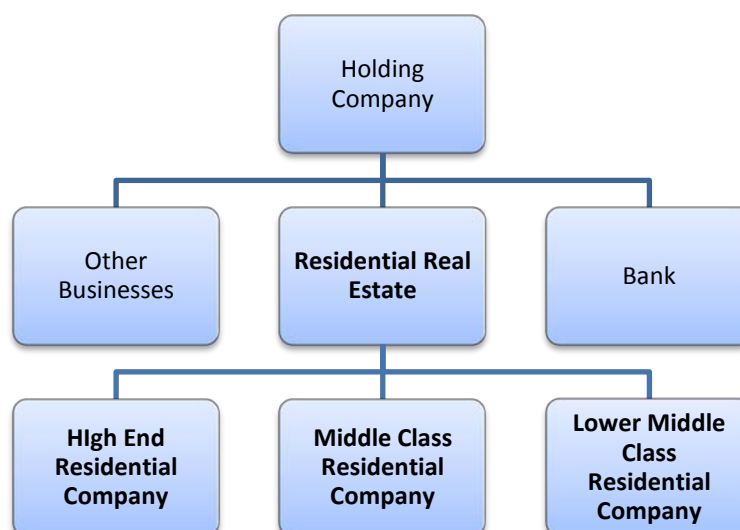
“In real estate, families have a web of two real estate companies, for example, the Sy Family with SM Prime. They have several companies: one for the high end, the other for the low end” – academic

“[Our] retail property is listed with SM Development Corporation where there is a 59% ownership interest and is the residential arm. It develops residential condominiums. There is also Highlands Prime where there is a 32% ownership interest. It is a targeted type of company [aimed at the market for] second houses or weekenders in Tagaytay.”-SM interviewee

This strategy was noticeable in Manila where real estate arms of business groups would have several different entities serving the various clienteles within the sector. This is a classic product portfolio strategy. Within the residential real estate sector, there would be one entity or brand that would serve the upper class; another would serve the middle class, while another would target the aspirational lower middle class. These three entities

would still be owned by the one real estate company of a business group.⁵¹ The following figure summarises where the residential property companies are within the portfolio of businesses of a group:

Figure 33: Residential Property in a Business Group Portfolio



This sector is growing, in large part due to the remittances of OFWs:

“The growth in the real estate sector over the last 2 years is due to OFWs. The OFWs will continue to boost the Philippine economy” – Jose Cuisia (2007)

Residential real estate in Manila has an established history dominated by business families:

“[The property sector is] dominated by families because it provides competition and challenges. For example, Ayala Land is reliable. Besides the Ayalas, there are other developers such as Henry Sy, Andrew Tan who entered the sector over the last 10-15 years. The Gotianuns since the 1960s have been quietly growing FillInvest/Alabang.” – private sector 1

“Our real estate business has created this community in Makati. But we now have Ayala Alabang, Ayala Heights in Quezon City, Cebu – the principal residence; the Techno Park where the Economic Zone is, was developed by Ayala. In Pampanga

⁵¹ For example, Ayala Land, the real estate arm owned by the Ayala Group, has three brands for its different target markets in the residential real estate sector: AyalaLand Premier for the upper class; Alveo for the upwardly mobile; and Avida for the aspirational class
<http://www.atayala.com/> accessed 4 October 2009

we are building a community; in Clark Air Base; we have a big tract of land as far south as Cagayan de Oro. Once the airport is built there, the big tract of land of 90 hectares, development in the area can go ahead.” – Ayala

The dominance of business groups and saturation of this sector has not gone unnoticed:

“It is an oligopoly – [there are a] few of you within the market. If you control one industry, in such a case there are different players within the industry. The different players are owned by different companies.” – academic

The competition in this industry is fierce and new entrants wait in the wings:

“[Regarding] the old structures, the grey market is strong in our market. Like the Ayalas, the new frontiers [are fraught with] more difficulty; for the grey market, there are competitors to follow. The Ayalas [are doing] pretty well. We viewed their strategy and joined the real estate market. Competition is good for the public.” – private sector 2

“We have relied on our core business which is real estate. During recent times there has been a lot of competition in the market. It is really a tough market in the real estate.”⁵² – Ayala

However to grow too big and for one business group to dominate the sector is not socially acceptable:

“[Ayala President] Zobel says there are other problems with scale. “Let’s say we wanted to be a pure real estate company. Size in the Western world is seen as a positive thing: you build economies of scale, market reach. Here, it’s socially unacceptable to become too big. So you start channelling things to new areas. By its very nature that’s why conglomerates continue to exist in Asia.” – Wright (2006)

Healthy competition and selective restraint is more agreeable than a monopolistic domination of the sector.

⁵² As pointed out by Dumol: “Ayala was owned by one of the richest families in the country. They own substantial land and have built up a huge corporate empire. Yet, during the last few years prior to the [water] bid, they had lost three of the largest real estate bids ever held. Metro Pacific was one of the companies that had beaten Ayala, which had led to serious corporate rivalry between the two.” (2000:68)

6.6.1.1 Challenges in the Property Sector

There are challenges in the property development. These are the speculative nature of the sector, foreign ownership controls and mutable property rights.

Property is highly speculative and has had its share of busts. The investment drought that followed the East Asian Crisis exposed several property groups, while a large part of non-performing loans (NPLs) were in this sector:

“The East Asian Crisis definitely had an effect. The crisis catalysed the need for reforms because that’s when you separated the men from the boys in a manner of speaking. Those who practiced good corporate governance such as the Ayalas, the MNCs, the banks survived the crisis. Those who weren’t practicing the principles suffered more such as Urbanbank, the Ramcar Group, and many real estate property developers.” –private sector 1

“[The East Asian crisis] showed governance issues for example in listed companies. There were severe governance issues in the real estate business that was pre-selling and retailing items without too much disclosure.” –SEC

“[There were some that] invested money in a property company owned by a family. [It was] not just very aggressive of selling products; the money received went to the sister company in real estate, and this sister company went under. It was actuarially unsound. 700,000 families were affected by the pre-need company and there was the real estate company. The SEC intervened when it was obvious it was a Ponzi scheme. When the music stopped, [they] tied up the hands, and seized the real estate.” –private sector 2

However, while the property sector is open to local competition, it is protected against foreign investment. For one company, the issue of a foreigner not being able to own property in the country has made it rethink its strategy in this sector:

“We’re into property development. We are principally driven by property. Some foreigners can own property for example we have a large foreign ownership of 35% from Singapore. The 40:60 principle applies -you can’t own land if you’re a foreigner. The exemption is for a condominium. A foreigner can own condos. There are other ways to form a corporation as long as you make sure it is Philippine-owned. Once it’s 60% Filipino owned; then the foreign can buy the

property. There's also a 50 year renewable lease. We had a roadshow in the US for our property condominiums. [Our] property in the Alabang area is our condo project. We have formed a property group [in addition] to our other businesses.”

– private sector 3

This 40:60 principle has allowed the domination of the sector by the local business groups but has placed major obstacles to foreign competitors. The restrictions on foreign ownership of land and development will continue in the foreseeable future, in large part due to pre-existing political arrangements that favour domestic participants. This is a remnant of the resentment felt under colonial rule when vast tracts of land were seized from the local inhabitants:

“Land developments and land for foreign ownership is constricted. The general feeling is to open up the economy remove restrictions [on land] but it's emotional. [It may be opened to foreigners] probably for private use but the development of land will still be controlled by oligarchs: Foreigners can own land but [they cannot own it to develop] for shopping malls.” – consultant

Another issue that must be considered by a company for any property development in the country is the combination of mutable property rights⁵³ and grinding poverty. In a metropolis of 11 million people with a population density of over 40,000 inhabitants per square kilometre⁵⁴, unoccupied land in Manila quickly becomes occupied. The matter of land titles becomes impractical with a teeming populace and unenforced laws:

“[On the issue of] landtitling⁵⁵...[and] land acquisition, the law should be fair on the market price. If you [distribute] a buy-out notice to shops that there is a sale of land, people get to know the [project] and buy the land. The government [takes to the] court [and the] dispute is part of the system that wants to have the

⁵³ On mutable property rights, see Rubio (2007) where an issue emerged over the dictator Marcos' family seeking control of real estate land owned by the Ortigas family which was seized during the Marcos years.

⁵⁴ <http://www.manilacityph.com/pdf/population.pdf> accessed 25 March 2009

⁵⁵ An interesting debate on the protection of property rights as a necessary demand for long-term investment, improve investor confidence, and address poverty appeared in the Economist in 2006 discussing Hernando de Soto's insight that “the lack of title that explains why poor people have been unable to turn their assets into capital...History suggests that as well as property rights and a decent legal system, it requires sound economic policies, an educated workforce and political arrangements capable of regulating conflicts and minimising the risk to investment. Then again, if development were easy, everyone would have already developed.”

law changed - once people find out there's a road being built, people start speculating and buy the land even [if transactions are] temporarily suspended." - consultant

"It is hard to have the security of titles here. There are squatters on your land, they have rights to it. So you can't just move the squatter. It's difficult to remove them or enforce your title. Title of land can be easily copied so if you have the original, keep it under lock and key. There are far more titles than there is land in this country." – private sector 4

Addressing this problematic issue has led to an initiative seeking to cap the distribution and amount of fake titles in the country (Manila Bulletin 2007). In practical terms, a real estate development must deal with existing squatters, how to co-opt the populace and mitigate community backlash before building can start:

"Another area Ayala Land has gone into is certain areas of the community. When we go in, there are squatters. We allot a certain portion of the property and build a small community together with the Ayala Foundation to teach and generate income for themselves. We thus gain the cooperation of building a community." – Ayala

A real estate business is a mainstay of a business group's investment portfolio. Less government interference in this area has allowed a flurry of competition to proliferate in this sector. Having established their core competencies and target market, this type of strategy provides an insight into how Philippines business groups operate and compete against each other in this sector (see also Kock & Guillen 2001 and Li et al 2006 for the different strategies available to business groups).

6.6.2 Competition and Participation in Other Sectors

Besides property which is the mainstay of a healthy business group portfolio, other sectors business groups are actively engaged and operate in include business-process outsourcing (BPO), resources and tourism. These sectors indicate where present and future business opportunities lie in the country.

6.6.2.1 Business Process Outsourcing (BPO)

Business process outsourcing (BPO) or call centre industry is the fastest growing sector in the country with an expected workforce of half a million in 2010 due in part to English-speaking, American-acculturated Filipino workforce (Business World 2007, Sanchez-Lacson 2007a). The country's pool of cheap labour force and English skills has made it attractive for multinational corporations to outsource their call centres to the Philippines although labour shortage and ensuring the English standards are consistent are concerns (Mangun 2007, Business World 2007):

"The services sector is growing but requires educated people. You can get P15K from a call centre, but is four or five times that amount in the USA, Australia. There is a real shortage with skilled people needed. Government is opening up [this sector] allowing the entry of foreigners." - consultant

It is also an internationally competitive industry with the Philippines competing with another English speaking country, India, for call centres:

"We are strong in services e.g. call centres. But I suspect the bottom line of the call centres are going to the Indian companies as they have gone to the high end of call centres. There is a boom in a call centres but we should be in the higher level not lower given our English skills so I am not happy about that. Nevertheless it provides employment." – private sector 1

As largely Anglo-American companies outsource their BPO, international standards apply which allows a transfer of international business practices to the country:

"Globalisation is competitive internationally. For example look at call centres. Foreigners want corporate governance. [They want] disclosure, co-investing with owners of Filipino entities. [We are] competing with India but Indians are [competitive]. Even for Europe. We have to do [corporate governance]. BPO in the medical transcription sector is substantial." –private sector 2

"Local Business Process Reengineering Organisations (BPO/Call Centre) who have American parents have seen their contracts comply with American Sarbanes Oxley, or if they have contracts with European organisations, the local BPOs comply with the Data Protection Directive. The companies qualify from the US

and the EU but are not equivalent to local laws. For American contracted BPOs the standards are that of SOX.” – private sector 3

Call centres are also influencing where the local government pension fund, Social Security System (SSS, see Chapter 8) sets up its branches in order to capture the economic activity this industry:

“In the service sector, call centres are up so we factor in that to decide where our branches will be situated. We put up the branches where the economic activities will happen. The transaction contribution is mandatory for the private sector. The contribution for them in total is 10.4% per month. 3.3% is deducted from the employees' salary so the rest of 7.1% is the contribution from the employer”-SSS

The BPO sector has also managed to survive the downturn of the global financial crisis:

“Investors have not left in droves, although a few foreign corporations in affected industries are closing shop, such as Intel and other electronic / computer providers. There is of course very little foreign investment and export industries are being hit. Outsourcing though is expected to continue to grow at a high rate i.e. there is some foreign investment. – private sector 3

BPO is a growth industry and provides a bright spot in private sector development in the country:

6.6.2.2 Resources: Mining and Biodiesel

Since foreign ownership restrictions in the mining sector were loosened in the country, Australian mining companies have made their presence known. At the monthly meetings of the ANZCHAM, it was notable to see that a substantial proportion of Australian investors present were from mining companies:

“[Mining is] currently a growth sector for the exchange. A lot of Australian mining companies are investing the country. During the 1950s and 1960s there was a substantial foreign investment in the sector a (boom) but then during the 70s and 80s there was the process of nationalisation and a 40% limit on foreign ownership which discouraged the sector's growth. The mining sector declined in the late 1970s and remained closed for the next 20 years.” – PSE

The PSE has also adopted the Philippine Mineral Reporting Code (PMRC) which would require listed resources companies to meet global disclosure standards. (Sanchez-Lacson 2007b) However, the players remain small and substantial investment from the big Australian resource companies are yet to materialise and make an impact. In particular, practices by some small Australian mining companies in local Filipino communities have come under scrutiny placing their corporate social responsibility practices under scrutiny (see Chapter 9: Corruption).

Notwithstanding the controversy mining brings, the Philippine's next door neighbour - China - has a resource-hungry economy, the country may be a far more acceptable partner for the middle kingdom than some Anglo-Australian mining companies (The Economist 2009b):

“As long as China requires stainless steel we have endless supplies of nickel. This country is so fertile you can spit on the ground and in one year's time, there will be something growing from the ground.” -SEC

“Mining is an economic potential. [China is the] biggest buyer of resources. You will have one dominant player in one sector. China will dominate operations.” – consultant

The other growth sector in the resources industry is biodiesel. For two of my interviewees, alternative sources for diesel include crops from sugar cane, coconut and jatropha:

“We are in jatropha which is a 100% diesel substitute with 5% of its emissions. 50% of fuels now come from fossil fuels. It used to be higher but the Philippines has now reduced its reliance on oil I'd like to say we are into two types of gold: Black gold of petroleum products and green gold of ethanol, alternative, sugar, air, and wind. We are focused on green gold. At BP we have 500 gas stations. [However, the industry has its share of] feast and famine when it comes to exploration.” – energy company 1

“It's a new market, bio-diesel. We use coconuts for the crop. Only in the Philippines is there a thriving export-based coconut industry. Indonesia [has a] bigger [market] but they use a lot of [coconuts] for food. So we are a surplus producer for vegetable oil, manufacture soaps, detergent. In the Bicol Region

they have coconut milk. The coconut oil miller is a fragmented market, there are many coconut farmers. It is market driven. There is no cartel. No single entity. But there are layers of middlemen. On the manufacturing side, there are coconut suppliers.

“The passing of the bio-fuels laws will provide long-term stability; bio-diesel for transportation and shipping, power generation, automotive, public transport. In the Philippines most of the transport here runs on diesel, so there are lots of consumers for private vehicles. It is a diesel-driven market. There are 1.43M vehicles here in the country and we are a dumping ground for used transport such as the second-hand Korean and Japanese buses that make the bulk of public transport in Manila.

“Biodiesel is a pollution mitigator. It improves fuel, reduce emissions, it’s a solution to pollution. [We are] at the forefront of the legislation that created the biofuels industry. The coconut farmers look at us to sustain the new market. The coconut farmers have a stake in our success. The biofuels industry [is] higher value added – we convert to higher value product for the export market. ” – energy company 2

With peak oil and energy crises a dominant feature of global geopolitics in the first decade of the 21st Century, demand for alternative sources to carbon-based fuel is growing. Opportunities are being seized to meet demand for cleaner energy and to reduce dependence on fuel produced externally.

6.6.2.3 Tourism

A tropical country with thousands of islands, the Philippines has the combination of surf, sand, beautiful coral atolls and weather to rival other tropical countries such as Thailand, Malaysia and Indonesia. The Visayan island of Boracay is internationally famous for its white sands and several of my interviewees encouraged me to visit the island (which I did). There is potential in the Philippine tourism industry (PDI 2007) but to realise this, it is dependent on various factors such as the availability of infrastructure; guaranteeing the safety and security of tourists; and better promotion of the country as a tourism destination. While Thailand has largely attracted Westerners, the Philippines is becoming a tourist destination for its wealthier Asian neighbours. For one business

group, targeting the growing middle class Chinese tourists to visit the Philippines is one strategy they are undertaking:

“We are not looking at other countries outside of China. China is close to the Philippines. We are looking at the tourism industry. Five years from now, there will be more Chinese tourists in the Philippines than the USA.” – SM

Government support of the industry will be crucial to the sector’s success especially in the areas of aviation, transportation and basic infrastructure such as roads and sanitation. The following exhibit is a scan of a full page advertisement in The Economist, part of a four page tourism promotion from the Philippine Department of Tourism.

Why just wish for a place in the sun
when you can own one?
Find your perfect home
on one of our 7,107 islands.

THE PHILIPPINES
www.Liveyourdreams.ph

The Philippine Department of Tourism

This ad appeared in The Economist, October 4th-10th edition, p.32 (pp. 28-32)

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section on privatisation of government owned utilities also provide opportunities for business groups to expand commercially.

6.6.3 Privatisation

Successful transitions of formerly state-owned companies to fully-fledged private sector companies take time. As state-owned companies, politicisation is a known hazard and the organisational culture differs from private-owned entities. When the government enterprise becomes private, the organisation is depoliticised from politicians but other pressures are enhanced: a profit-oriented culture, rigour in risk management and compliance with corporate governance guidelines. The next section looks at one of the more successful privatisations in the country, Manila Water, and how the company transitioned to a well-run and well-governed profit-making company.

6.6.3.1 Case Study of a Privatisation: Manila Water

Access to clean and potable water is critical in urban Philippines (see Chapter 9 on the lack of access to clean water and the breastmilk powder industry in the country). The privatisation of water is a sensitive politico-economical issue in any country. The decision to privatise the water supply of Manila was justified on the grounds the city did not have a 24 hour water supply, illegal connections proliferated, and it was a financial burden on the government. (Wu and Malaluan 2008: 213)

In 1997, Metro Manila's water was divided into two concessionaries: the East Zone and West Zone. The decision to divide the water privatisation into two zones provides an almost textbook exemplar into comparing and contrasting the positive and negative effects of a privatisation experience. The winning bidder for the East Zone was the Ayala family-backed international consortium Manila Water, while the Lopez family-backed international consortium Maynilad Water won the West Zone concessionary (2008: 213, 217).

One criticism of the winning bids focused on the family owners as this reinforced the power and concentration of wealth of the two business families. However, an official involved in the privatisation thought this a moot point as business families dominate the country's private sector and it was stipulated that the winning bids had to come from local companies with majority control, and not foreigners:

“People raised the issue of the overwhelming political and economic power held by the Lopezes and Ayalas, which needed to be held in check. Otherwise, these families could abuse this power....[but] if the largest water privatisation in the world was being carried out, you would expect that only the largest companies in the country would have the resources to participate in the bidding.” (Dumol 2000: 102-103)

A decade on from the water privatisation, the outcomes between the two companies could not have been more different. Manila Water, the operator of the East Zone, turned a profit in 1999 and listed successfully on the PSE in 2005. Manila Water is still in the hands of its original bidders and is now expanding internationally. It is also the subject of a Harvard Business School case study (Rangan 2007) and has received many corporate governance awards in the region. Maynilad Water, on the other hand, never managed to turn a profit under its original owners and suffered various problems. In 2005, the original consortium withdrew from operating the West Zone and is now in the hands of new owners and operators.

Ceteris paribus, why did the experiences of these two private sector operators differ so dramatically?

Wu and Malaluan link the successful outcomes of a privatisation to several factors including the initial vision towards the privatised company; instilling a new corporate culture; and co-opting the former government employees by training and upskilling them into becoming professional private sector managers. Co-opting the former government employees Manila Water had open tenders instead of engaging in intercompany (or related party) transactions which proved to be of better value than sourcing within a related party. (2008: 218, 221).

Furthermore, Wu and Malaluan argue the success of the East Zone’s operations can be largely attributed to the corporate governance principles instilled in the company. The culture of the parent company passed on its values to the privatised company generating an atmosphere of inclusiveness amongst employees. Five years after the privatisation, 95% of Manila Water’s employees were retained from the old public sector company. For Maynilad Water, the opposite happened with new senior management personnel parachuted in. This caused resentment amongst the old employees (2008: 221, 223).

Wu and Malaluan strongly suggest that pre-existing corporate governance practices of a bidder plays an important role in the quality and successful outcomes of a privatisation and future privatisations ought to take into account a potential bidder's corporate governance practice before awarding the contract:

“Although a private water company's management determines the quality of its corporate governance practices, the public sector has ample opportunities to influence corporate governance processes through the bidding process, regulatory actions and asset ownership. Government officials guiding the bidding process would be wise to pay attention to each bidder's corporate governance, as these could be an indicator of how that bidder might perform if awarded the contract. Government can also include good corporate governance practices in concession agreements. (2008:219; see also 225-226)

It is difficult to implement good corporate governance in a newly acquired company when it does not exist in the first place. In this case, the owner practised a culture of good corporate governance and this was inherited by the privatised company.

6.7 Unaffiliated Business Groups

There are some stand-alone, unaffiliated companies in the country such as subsidiaries of foreign companies. The Philippine subsidiary of Manulife, a Canadian insurance giant, demutualised and listed on the PSE as it had a large policyholder base in the country. Asking what effects listing on the PSE have had on the company especially in terms of its corporate governance, Manulife Philippines responded:

“Indirectly, there has been some effect. Being a listed company, Manulife reaffirmed its commitment to adhere to the highest standards of corporate governance and further reinforced its corporate governance practices, setting the tone from the top. This was then cascaded to all its subsidiaries, including Manulife Philippines. Further, local regulations have appreciably changed in recent years, giving added attention to corporate governance. Especially considering that Manulife Philippines is a subsidiary of a listed company, it has to comply with these corporate governance regulations. Manulife does not have large family holding companies in its shareholder registry list.” – Manulife

However, Manulife's non-affiliated ownership and listing is the exception rather than the rule. The following box is my interviewee from ATR Kim Eng describes his company, an unaffiliated investment house, and how it bears the hallmark of a Philippine business group. ATR Kim Eng has its origins after buying out a subsidiary of an MNC, divesting this subsidiary and expanding into other sectors:

Text Box 5: Development of a Non Family-Owned Business Group

Origins

"Our company [ATR Kim Eng (2009)] is in a different situation [compared to most family business groups]. We used to be called PhilTread Holdings. PhilTread was in tyres and rubber. Prior to that it was called Firestone, the American tyre maker. Firestone here was set up a 100% owned subsidiary. Once it was divested the stake was less than 25%. There was a trademark dispute between Firestone and Bridgestone; Bridgestone is the Japanese tyre maker. Firestone said the Bridgestone name was similar to theirs. Bridgestone argued that the Japanese name was Stonebridge which was Bridgestone in English. Firestone started to lose its position when it announced in the 1980s that it was only aiming to be the second biggest manufacture of tyres instead of number one. It was going well until it was hit by a product liability suit stating that there were faulty tyres in the USA which caused cars to explode. Eventually, Firestone was bought by Bridgestone. In 1994, Firestone Philippines was hit by severe labour problems. It had a militant union and Firestone closed off the plant. It fired off the militant union. After 13 years the Supreme Court judgement found in favour of ATR which had bought the Firestone subsidiary in 1997. ATR sold off the tyre plant assets it owned to CM Tyres (Thailand) and Michelin (France).

Expansion

"ATR formed a property group called Sucat Land and SMF - a leasing property - for the tyre manufacturing. However, the militant union gave Michelin problems so Michelin shut the plant in 2001. We were the lessor of the property so the Asian crisis didn't hit us. However, as far as I am concerned though, it was a turning point of the partners of ATR. Just before the crisis there was the management buy-out. ATR has always been conscious of good governance prior to current legislative requirements. There was the acquisition by ATR Kim Eng of the PhilEx mining company which had a diverse shareholder base. PhilEx is still listed. Both Philex and Bridgestone/Firestone had a public shareholder base so they were always used to operating under good governance.

Ownership and Control

"At ATR there is no dominant family, just dominant groups. ATR stands for the names of three partners: Arnaiz, Tordesillas and Roxas. All three were at Peregrine Capital when they decided to do a leverage buy out of it December 1996. ATR owns around 45% of the company, KimEng - which is the largest publicly listed brokerage in Singapore - 35% and the public the rest. The two histories of both [PhilEx and PhilTread] companies show they were never family controlled. PhilTread had pretty prominent families in its shareholder list. But if you check PhilEx, it had the most diverse ownership. Apart from SSS, there was no single stockholder which had more than 6.8% stake. We are an honest to goodness public corporation.

Professional Management

“At ATR we had professional officers even when it was Peregrine Capital. Peregrine was not a family corporation. There was no dominant family. Even in the case of KimEng. The largest ownership stake is 6%. The biggest owner of KimEng is from Taiwan. We’re a professional corporation and our flagship business is investment banking with property and insurance as the other two arms. So we have professional people, stock brokerage, money broking, mutual funds. We are a mutual fund company of the Philippines. We make sure we have distinguished hands. We’re fortunate our seniors are very Western oriented. We’re coming from an MNC environment. We don’t see any cultural hindrance.”

Business groups are the common corporate structure in the Philippines even for those which have non-family owners.

6.8 Relationship with Minority Shareholders

Business groups and how they communicate with, and respect the rights of, minority shareholders are major indicators on whether they practice good corporate governance or not:

“If you are an analyst, you have a track record of how management is. For example, on the equities side of corporate governance, if the company looks after the minority shareholder interests, then it’s a good investment if they look out for all shareholders and how they treat minorities...How do [they] deal with minorities? Do owners screw the minorities? So do your homework for investing.” – stockbroker

This section covers minority shareholders (or domestic retail investors), foreign investors and stakeholders.

6.8.1 Minority Shareholder Population

The number of minority shareholders (or domestic retail investors) in the Philippines is subject to some debate. However, most agree that it is quite small. Unlike Australia where a series of privatised assets and mandatory superannuation for workers saw the shareholder population swell to over half of the citizenry, the Philippine shareholder population is still the domain of the elite and a few despite the bull market of 2007:

“There is increased public ownership, more shareholders are now in existence –

nobody has written a thesis (for which I am willing to fund) on how many shareholders are there in the Philippines. My guess is 0.5% to 0.75% of the population because I don't think even 1% of the population or 800,000 people own shares." – stockbroker

"The shareholders are thinly dispersed, nobody really owns a chunk. There's around 9000 shareholders who own at least 1,000 shares, and 3,000 owning less than that."-private sector 1

With a population where at least half of the population subsists on less than USD1 a day, stock market investing is far from the minds of many:

"[It's an issue on] how to build culture of investment in the country when 80% do not have the means nor the interest in investing." – private sector 2

While the privatisation wave of the 1980s and 1990s was a contributory factor in developed economies to increase the shareholder population in countries, this process did not have the same effect in the Philippines:

"With regards to privatisation to spread the shareholder base, with the listing of Petron it didn't occur. I don't think there are enough people here with excess savings to put money in the stock market. There is a high concentration of wealth in the country and only a small percentage of the country that can afford to get into the stock market: institution and big brokers. Most people are just in traditional savings." – academic

As a small listed exchange, the private sector needs to be bolstered and not necessarily by making more investments in the few companies that are listed, but fostering other activities:

"The retail investors are very rich Filipinos. Improve the investor base [but at the same time], address the problem of poverty. In the long term, address inequality at very low levels of income. What people need is microfinance and new entrepreneurial initiatives." – academic

Improving the domestic retail shareholder base must be linked to generating wealth for more people and decreasing poverty.

6.8.2 Rights of Shareholders

For minority shareholders of Filipino corporations, their rights are covered and provided for under the Philippine Corporation Code overseen by the SEC. These rights include voting, dividend, derivative, appraisal, and the ability to access company information:

“Shareholders of the company have all the rights provided for in the Philippine corporation code:

- Voting right
- Dividend right – in January this year, the board of directors of the company voted to adopt a policy of distributing at least one-third of the company’s earnings for the previous year as cash dividend to its stockholders.
- Derivative right – the right of a shareholder to institute proceedings on behalf of the corporation in a derivative action in cases where the company itself is unable or unwilling to institute the necessary proceedings to redress wrongs committed against the company or vindicate corporate rights, as where the directors themselves are the malefactors.
- Appraisal right – right of a dissenting shareholder who voted against certain proposed corporate action/s to require the corporation to purchase his shares at a fair value.
- Right to inspect corporate records in accordance with the Philippine corporation code.
- Right to information” – private sector 1

Most interviewees mentioned voting rights on the top of the list as what shareholders are entitled to. Others included receiving information and attending AGMs:

“Voting rights, right to dividends, directors voting, rights to information, copies of information of operations. The Philippine Corporate Code provides basic rights to shareholders.” - PLDT

“We inform investors on what’s happening. We send the notices in an agenda. The investors may thus respond: on item #1 we vote yes; on item #2 we abstain. This voting goes on record. We have also removed pre-emptive rights: if new

shares are issued, there is a privileged few who get first dibs. We have removed that and it was a popular move.” – private sector 2

The right of appraisal - where a dissatisfied shareholder may be bought out by the company - was mentioned by a couple of interviewees although this right is rarely exercised:

“If the shareholder doesn’t like the way the company is being run, we can buy him out but it is not invoked here much as you can just sell the shares. Our philosophy is to be fair to all shareholders. They worry the most if the value of the company depreciates.” – private sector 3

“Appraisal rights – in any instances of the law, a claim of appraisal rights – inform the company to repurchase back the shares but we are not aware of a shareholder exercising their appraisal rights.” –private sector 4

However, the reality of minor shareholdings mean rights such as the right to vote may be merely be symbolic:

“The shareholders have a right to be notified to the meetings. These are standard rights. There are voting rights on the reduction of directors, changes in the articles of incorporation, if you dispose of all the assets. They vote on directors. They nominate, but in the past two years I haven’t seen a [minority] shareholder nominate other than the [major shareholders].” –private sector 5

“There’s cumulative voting. It’s not like 2.5B shares divided by seven and you get a board seat but obviously if you have that big enough shareholding (1/7 of 2.5B c.357M shares) you’ll get a seat. If it’s less you can still get a board seat through cumulative voting. A band of minority shareholders can get together and accumulate their voting. Each shareholder is entitled to vote for seven directors and they could use their votes to elect one director. But in general, shareholders don’t have much say as nobody owns big chunks. On paper they have rights but they are small and can’t really do much.” –private sector 6

The frankness of the last comment shows the reality of minority shareholders’ rights.

6.8.2.1 Annual General Meetings or AGMs

Another right every shareholder has is attendance of annual general meetings (AGMs) where the company's performance over the past year is presented, company directors are elected, and board queries from shareholders are fielded and answered.

“Every year the company also sends out to all shareholders together with the notice of the annual stockholders' meeting an information statement containing the audited financial statements of the company as well as the management discussion and analysis of the financial results. The management team of the company also presents to the shareholders during the annual stockholders' meeting the operational results of the company. An open forum, where shareholders can directly ask the management team questions, is held right after the presentation.” –private sector 1

However, in the Philippine corporate environment, AGMs are passive affairs, similar to the rest of East Asia:

“The SEC used to attend AGMs but not anymore. AGMs are only open to the stockholder. AGMs are scripted; most shareholders do not attend and are there by proxy.” - SEC

“The AGMs are open to shareholders but the AGMs here are staged, unlike AGMs in Australia. There used to be questions on the floor for nominations but not anymore. AGMs here last for half a day.” – ICD

“The AGMs are mild. Basically, there are no fireworks. The shareholder on the floor is free to query us.” –private sector 2

“The shareholder meeting is more procedural” –private sector 3

And in a society that values face and non-confrontation, awkward questions are equally not as welcomed from the company side:

“In Filipino culture, we are not that aggressive. When corporations hold annual meetings, they accomplish and achieve, new directors are elected. It is a very passive environment.” – GSIS

“Fortunately there is no [minority activism]. Every AGM, we always hear from our

shareholders congratulations and they'd approve acts of our directors. In other words, we don't practically get questions at all on our financial statements over the past 20 years. During the shareholders' meeting, the chair will announce: if you have any questions ask the CEO. Hardly anybody asks questions even for clarification. The questions I get are from board members, not from shareholders." –director

AGMs are also not well-attended:

"Shareholders are passive. During the annual meeting, there are 300 out of 5000 attending. We organised a *merienda* (tea) and show bags for them. Most are retail investors. There is a mail out but there is very little communication from them. We send out a communication once a year which is the notice for the AGM." – private sector 4

"At the AGM we distribute our annual report and each shareholder receives it (the annual report itself is quite small and thin, it's an A5 size). Every year we distribute it. This year there were less than 150 people attending." –private sector 5

AGMs are important fora for disclosing company information as some listed companies still do not disclose information on their websites – if they have one:

"The investor relations function here is informal. Most shareholder interest is around the AGM. There is mandatory quarterly reporting. We hope to provide disclosure in terms of infrastructure, but we're not quite there yet. Eventually." – private sector 6

For one company that does have an investor relations (IR) department, this function has allowed to publicise the success of the business and facilitated better communication with outsiders:

"When the company listed in 2005, it took a while to get the investor relations (IR) department established ourselves. There was a matter of the share price. When the company was listed, it was a new way of organising. The share price wasn't performing much. People couldn't understand what the company was about. The IR department was created in June 2006. So it took some time before

it got established. The share price has increased since I have been here. [While the PSE is doing well] we have outperformed the market from August last year. The company is playing catch up with the market. Putting modesty aside, I'd like to say the IR department contributed in part in getting [the attention of] investors. The company has solid fundamentals and will continue with an increasingly aggressive coming campaign. It is a growth story despite its size. It has competent managers and professionals.” – SM

For listed companies who do not have a dedicated investor relations department, the AGM remains the most important venue for disclosing information on company activities other than the PSE.

6.8.2.2 Communicating with Shareholders

Most interviewees spoke about disclosing information to shareholders in terms of complying with the requirements of the PSE and SEC.

“In accordance with the Philippine Securities Regulation Code, the company releases information about a material event to the Philippine Stock Exchange (PSE) immediately after the occurrence of such material event, copy furnished the Philippine securities and exchange commission. The company also releases the information to the news media and through its corporate website immediately after disclosing the information with the PSE.” – private sector 1

“There are several ways we communicate: If there are major happenings acquisitions, we're required to disclose it to the PSE. The PSE publicly makes the information available” – private sector 2

For the established players, an investor relations or corporate governance office is a formal division within the company:

“Trust is an issue. The PLDT Corporate Governance office is here to address the interest of shareholders. These policies are there to protect and address the needs of shareholders.” – PLDT

“As mentioned earlier, all our disclosures are posted in the company website. This includes financial reports, quarterly and annual as required by SEC. In addition, we respond promptly to request for clarification on news item coming

from the Philippine Stock Exchange. Our Investor Relations group also conduct periodically sessions with media and the financial sector/markets and investment analysts.” - Petron

Companies also use websites, newspapers, telephones, faxes and emails to communicate with shareholders:

“Manulife communicates with its shareholders’ regularly and through a number of avenues: On a quarterly basis, Manulife releases its quarterly financial results. Specific disclosures include Manulife’s quarterly shareholders’ report, press release and quarterly statistical information package. We also hold a quarterly earnings conference call which is hosted by our President and Chief Executive Officer and our Chief Financial Officer. Annual communication includes our Annual Meeting and various documents including Manulife’s annual report, proxy circular and annual information form. Ongoing communication includes widely distributed press releases and our external website (www.manulife.com) which contains a significant amount of information on Manulife.” – Manulife

“The company has a corporate website which contain information on the different businesses the company has interests in, latest corporate news, corporate disclosures, quarterly and annual financial reports and stock price. Shareholders may also subscribe to an electronic newsletter published by the company. Shareholders can also email or call the company’s investor relations group for questions about their shareholdings.” – private sector 3

“The company has minority shareholders and foreign investors who are free to air their concerns during stockholders meetings, or by writing, calling, faxing or sending an e-mail. Management listens to their concerns and tries to address them.” – private sector 4

However, for less well-resourced companies it does come down to a matter of cost in disclosing actively apart from the mandatory regulatory requirements:

“We have to point out [to our employees] that corporate governance is not a cost but it’s an investment. However corporate governance can be costly as not everyone could have an investor relations department.” –private sector 5

For the smaller players, company secretaries are the main point of contact:

“We have regular media releases it goes through the company secretary. The prospectus issued at the IPOs and that’s still in place. The shareholders are treated equally, they can buy/sell. That’s fine. We have around 10,000 shareholders.” – private sector 6

A particular Philippine trait, mobile phone text messaging, is widely used to communicate with investors. Landline phone access never took off in the country and the waiting list for a landline was half a dozen years according to one source. Given the paucity of telecommunications infrastructure in the country, mobile phone technology has leapfrogged this altogether and Filipinos are one of the highest users of mobile text messaging in the world:

“Yes, our shareholders can contact us through text message, email, telephone. All disclosures are posted in the company website. Shareholders are furnished ahead of time copies of the notice of meeting, Information Statement and Annual Report.” – Petron

Texting places the country at the vanguard of this mobile technology and during my fieldwork, was the main form of business communication:

“We are the world leader in texting; around 30% of the world’s texts come from here.” - consultant

The PSE is an active user of texting in ensuring disclosure requirements are being met by listed companies:

“We don’t text official communication, but we use text as a medium to supplement communication. For example, the PSE can serve notice requiring an explanation to respond before 9am. If we don’t come up at 8am, one of the PSE disclosure officers texts us “when can we get your response?” We request a formal communication for it to be official and we have an official number imprinted in our communications with the PSE.”-private sector 7

“The PSE have a nasty habit of texting me for information. The PSE texts me while I’m in traffic or on the road and I ask them to give me two minutes extra. I send the reply automatically due to the principals. I’m going on holiday ...and

nobody will be at the office. I am worried that if anything happens I must answer by 9am. They send an email - If my secretary comes at 8 to 8.30am, I have to verify the answer without knowing the exact details.” – private sector 8

In this regard, the PSE is at the vanguard of capital market regulators in using this technology to regulate companies.

6.8.2.3 Dividends

The declaration of dividends is the main way companies acknowledge shareholder value. As one interviewee pointed out, dividends are “corporate governance by value”. Unlike Anglo-American companies where share price rise and gain is the material point of shareholder value creation and destruction, the ability of a Philippine company to issue dividends is how a company emphasises shareholder value.

“Yes [shareholder value] is very important. We make it a point every year to declare dividends and that’s the form of increasing shareholder value. However we’re focused on long-term shareholder value... We are careful to identify opportunities that will be profitable for the company and the shareholders so that’s for the long term. The focus is to increase shareholder value. But we are more focused in the long term. Short-term is one year. Every year we’re able to make dividends.” – private sector 1

“We do emphasise shareholder value a lot. We measure shareholder value constantly, and we do attempt to balance the long- and short-term shareholder value needs. We have instituted a policy of paying out cash dividends annually equivalent to 33.3% of the prior year’s earnings. The balance allows us to grow the business, either through acquisitions or through organic expansion. This long-term growth in shareholder value we measure primarily through the stock price.” – private sector 2

Declaring dividends is also a way to appease shareholders. One interviewee pointed out receiving dividends is the main shareholder right:

“What kind of shareholder rights exists in the company? Dividends. An average 3% of 20P a year.” – private sector 3

Issuing dividends also deters complaints:

“The retail investors are not active. They get their dividends regularly so they don’t complain.” – private sector 4

Most Western corporations issue cash dividends. One Philippine company – under the direction of their major shareholder – issued shares in lieu of cash payments in 2007:

“[The] company especially the board of directors always look into creating shareholder value. Every stockholder meeting, it is important that we generate shareholder value in investments. In the shareholder meeting: we issue stock or cash dividend. This year it’s a stock dividend. Last year the shareholders expressed the view that they want a declaration of a stock instead of cash dividends (which we have done for the last 2 years). So this year, we declared stock dividends and this will be paid out in June. The long term purpose of good corporate governance is to create shareholder value. We are conscious of this role. In fact, whenever we have had a bond offering, growth from shares, opportunity to make additional investments in bond offering -to give opportunities to any shareholder to make a bond offering which offers a higher yield.” – private sector 5

For FEU in particular, shareholder value maximisation is an alien concept. The goal of the listed entity is not to maximise profit but to ensure the ongoing operational existence of the school. The dividend policy differs with an emphasis on retained earnings being ploughed back into the school rather distributing what is available back to shareholders:

“We issue dividends every year. There are regular cash dividends in January and July. With stock dividends, we issue them whenever it is allowable. We declared 50% of the dividends to be stock 3 years ago. The FEU website has a history of our dividend declarations. The website also shows our investor relations. When you look at the retained earnings, even our dividend policy, it’s not like the other corporations. We are not distributing more to shareholders; we are not exceeding our yearly income for cash dividends. This is limited to 25% or 35%. Our income flows back to the school. ”- FEU

For a company which has had problems in the past with its debt levels, issuing dividends to all shareholders is a sign of positive financial health:

“Shareholder value enhancement is the primary objective in dealing with the creditors with respect to the ongoing debt restructuring process, in making investment decisions, and in setting policy decisions governing the conduct of the various business operations under the group. At some point hopefully in the not too distant future, the plan is to distribute regular cash dividends to the shareholders.” – private sector 6

Issuing dividends is a sign that companies are conscious of this fundamental shareholder right, and this contributes to greater awareness of corporate governance in general.

Issuing dividends wasn't the norm before:

“I'd assume corporate governance in the past few years have been strengthened probably because rules have changed and tightened. Investors and shareholders are more familiar with the responsibilities of the company. Before, you didn't get dividends and that was ok. But now, the norm is to give back to shareholders. Lots of companies now distribute dividends. For a listed company, it's becoming the norm to issue dividends. There's also transparency – companies that are not being run well, you see lots of items in the newspaper. We want to institute governance mechanisms so you don't get these kinds of disputes.” – private sector 7

Reiteratively, maximising shareholder value is a recent largely Anglo-American concept that has its fair share of detractors as it has benefited the managerial class. As one interviewee pointed out, corporate governance is more encompassing than the market value of a company:

“There are issues of the control of land that needs to be addressed once you talk about corporate governance in family corporations. You need a broader view of stakeholders, communities and where they come from. Corporate governance is inadequate (if you simply take the narrow approach). [The] shareholder value discourse benefits the [foreign] institutional investors.” – academic

For well-governed companies in the Philippines, short-term shareholder value maximisation is not common. Philippine companies exist to benefit their owners and long-term goals of owners. While there are corporate governance problems in the Philippines, short-term shareholder value maximisation is not one of them. This issue

remains a particular and pertinent problem for Western corporations and their stakeholders.

6.8.3 Shareholder Value

Another way where Philippine corporate governance practices fundamentally differ from Anglo-American corporations is in the concept and perception of shareholder value. For most companies, shareholder value represents the majority shareholders' interests and the orientation is long-term:

“Of course [we emphasise shareholder value]. One advantage is our management's view is effectively the same on shareholder value. Our seniors are owners themselves. They are not looking at shareholder gain as they'd be killing themselves as shareholders [to meet quarterly reporting]. They own substantial chunks. [This is] good for smaller shareholders as the management team is led by shareholders themselves. It's a congruence of objectives. The family-run corporations won't share [the value with] the public. We do.” –private sector 1

The alignment between majority owners and managers mean shareholder value and long-term company performance is intimately linked and aligned. Indeed, too much short-term shareholder value is not a good thing as Western corporations and shareholders have realised. Unlike Western managers who are rewarded with several remunerative devices, owner-managers in the Philippines have a less complex approach to risk and reward:

“The Board represents the stockholders' interest in perpetuating a successful business, including optimising long-term financial returns. It is responsible for determining that the Corporation is managed in such a way to ensure such result.” – private sector 2

“Manulife is focused on creating shareholder value, which we believe requires a long-term perspective.” – Manulife

Maximising shareholder value in the shortest time possible is not a mantra to be found in companies that practice corporate governance in the country.

6.8.4 Minority Shareholder Protection

While maximising shareholder value may not be a problem in the country, minority shareholder protection- or lack thereof - is a big issue in Philippine corporate governance. As listed companies have dominant owners, the force and will of their principals are undeniable. Minority shareholder rights can be disregarded or unprotected. Demanding a greater form of participation in businesses that are run like mini empires can be challenging. Listing on the PSE means greater transparency and information for all shareholders, not just a few. However, some business groups have not realised this. Indeed, one interviewee was critical of the demands made by minority investors:

“Here in the Philippines, the publicly listed corporations have so many shareholders everybody wants to be generals not followers.” -private sector 1

This is the downside of listing for a business family – being accountable to many small shareholders all with different interests and perspectives on the company. Untimely disclosure, insider trading, mismanagement and misinformation are common devices where a major shareholder can exploit minority shareholders in a business group structure as Bonbright & Means pointed out:

“Mismanagement is used herein to mean management of the subsidiary in the interest of the dominant company adversely to the interests of the minority stockholders. The various types of mismanagement against which minority stockholders have complained may be divided into three main classes: 1) diversion of funds or of business, 2) unfavourable contracts, 3) consolidation and dissolution.” (1969: 344-345)

While there is not the classic agency problem in the Philippines, interviewees generally support the Agency Theory II problem identified by Villalonga & Amit and others (see Chapter 2 Literature Review: Limitations of Agency Theory) and the concern over minority shareholder protection. Some interviewees, including the regulator, concurred that minority shareholder rights are flimsily protected.

“Yes. In law they have enough protection but shareholders need to be educated about the extent of their rights so corporations would not be caught out there,

sleeping. If minority shareholders are active, they are not practising. [Minority shareholders] should make the necessary noise about corporations who are in violation so they'll be helpful to the SEC." – SEC

"[Most companies deal with minority shareholders] not terribly well. One has to be careful on the issues and companies that you deal with. You don't have minority suits in this country. Broad shareholder value is not here yet. In time, shareholder value is getting rigour. One swallow does not a summer make. In terms of companies and how they handle minority shareholders, if they are sensitive to stakeholder management - it's not there yet. There is a cultural shift and a resistance of the board. It's changing but changing with resistance assisted by the younger generation. It is a global phenomenon. [It's companies] not wanting to change dramatically, not as rapidly as we would like to see." – private sector 2

"The problem is minority shareholders' interests are not considered as much as there are so few people [who are shareholders]. There is no protection of minority shareholders. It is a question of enforcement." – academic

A couple of interviewees mentioned preventative measures against insider trading as this would have an adverse impact on their minority shareholders:

"As head of the corporate governance group, when there's a material event, we make a disclosure. It's part of good corporate governance practices on adopting a trading blackout of executives and covered persons." – private sector 3

"No employee of the company can take advantage of material information. There is a trading blackout 10 days prior to disclosure and 3 days thereafter, no affected executive should buy or sell shares in all publicly listed companies. We are conscious of material information and of acquiring because of our position and gain economic [advantages]." –private sector 4

While a booming stockmarket makes insider trading attractive:

"Insider trading is hard in the case of [a widely owned company.] But with a booming stockmarket [in 2007], the family [insider owners] is much more important than before in the 70s, 80s." – private sector 5

“Many small markets that are vulnerable to influences are driven by insider information.” –investment banker

For those who practice good corporate governance, it comes down to the will and self-control not to abuse one’s position of power and privileged information in ensuring the rights of all shareholders are protected.

6.8.5 Rewarding Minority Shareholder Protection

Minority shareholder protection is a big indicator of whether the company is a good investment or not for an outsider. If listed companies are opaque and aren’t materially disclosing financial information in a timely manner, then that forms part of a corporate governance assessment. Therefore, companies that do protect minority investors are rewarded for doing so. As one interviewee bluntly put it:

“The equities with corporate governance, if the market’s dead – who cares? Even in dead markets it’s harder [to find value]. What happened from 1996-99, companies had difficulties rebounding when they weren’t protecting their little, minority shareholders. Ayala Land, PLDT were rewarded far more quickly because they protected their minority shareholders, political immunity, and were clean, solid blue chip names – faster than those who didn’t. In emerging Asian markets, with a trustworthy management, [they were rewarded.]” – stockbroker

While in one workshop, one speaker mentioned that especially in emerging markets, companies that rise above their environment and practice good corporate governance are rewarded highly above their peers (see also Chapter 2 Literature Review on Corruption, Poverty and Corporate Governance):

“In managed funds, they want a safe haven for investments. No country has the perfect corporate governance. But we have learnt that companies that practice good corporate governance have a 25-30% premium.” – CG workshop

However, the fact remains minority shareholder protection or lack thereof, is one of the main hazards of investing in a developing market. With a dominant shareholder, not all shareholders are treated or expected to be treated equally. But those companies who do, they are rewarded for going against the general trend and disclosing above and beyond the minimal requirements and disclosing to all investors, and not just a select few.

6.8.6 Minority Shareholder Activism

Minority shareholders are perceived as being quite passive at exercising their rights:

“Shareholders are on the passive and restrained side.”-private sector 1

“By Philippine standards, the investors are not demanding.” –private sector 2

While the rest of East Asia is awakening to minority shareholder activism, this concept is generally alien in the country:

“There is not a culture of shareholder activism in this country as there is so much familiarity. Multinationals are not proactive and most of the foreign investors are very nice. Shareholders are on the passive and restrained side.”-private sector 3

“The minority shareholders of PLDT are not really active. Minority shareholder activism lately such as some groups in South Korea, some groups in Japan with one organised asking for particular representation on the board. But not on PLDT, not in the Philippines. SSS is not active.” -PLDT

When there is minority shareholder action, it does receive coverage as so few of them occur. Whilst collecting data, a case occurred of minority investors actively exercising their right to be informed and have information disclosed to them. The minority investors of the listed company Philippine Racing Club Inc. (PRCI) took to the media in their want for more disclosure against the majority owners who were Malaysian foreign investors. The racing club owns the Santa Ana track which sits on prime real estate land in the heart of Makati and the foreign investors were property developers:

“...the Santa Ana race track is PRCI's prime asset and sole and exclusive location on which it conducts the business of a race course. The majority shareholders haven't disclosed a thing about the plan at all. We (minority shareholders) requested for pertinent documents, request for copy of all records, documents contracts etc related to acquisition. Again they denied our request. Where is the transparency there? Our rights as shareholders have been completely ignored. All that we in the minority are after is full transparency and disclosure from the majority shareholders. Is that too much to ask?” –minority shareholder (Business World 2007)

Foreign ownership limitations and the SEC's enforcement of existing corporate governance regulations were also highlighted by the investors:

“PRCI's foreign ownership limitations were breached...We will continue to oppose moves by the Malaysian-led group to transfer ownership of Santa Ana racetrack to JTH Davies through their proposed swap. We may be the minority but we still have rights and we deserve to be heard. All we want is full and complete transparency and disclosure. The Philippine Code of Corporate Governance mandates such transparency and disclosure for the protection of the investing public and shareholders whether majority or minority. The government, through the SEC, must ensure that provisions of the Code are adhered to by all listed companies doing business in the Philippines. It should step in quickly to prevent the mockery of the Constitution and its own Code of Corporate Governance. Otherwise, why bother putting it in place at all?” – minority shareholder (Arnaldo 2007)

Several communications made to PRCI asking for an interview went unanswered.

The above case is one example of minority shareholders trying to be active in the country. At the very the discourse of corporate governance is spreading and minority investors are realising that they do have and are entitled to exercise their rights.

6.8.7 Minority Shareholders Association

Frustration with the lack of disclosure, lack of enforcement and not so active regulators were the topics of a conversation I had with one minority shareholder who happened to be a senior executive at a blue chip company. There was the all too familiar story of lack of information, the SEC and PSE's lack of regulatory oversight over the quick decline in the company's share price, and the principals' severe lack of transparency. I could only repeat the comments made to me that the PSE is an emerging market and the safer bet for one's money would be with the blue-chip stocks. Anything beyond companies that aren't covered by the index funds or financial analysts places the investor in the speculative realm of insider trading and a gambling scenario not so dissimilar from a casino. The conversation was not encouraging.

Minority shareholders, in general, are loyal to their shareholding and hold on to the

shares for the long-term. Minority shareholders make an assessment based on publicly available information on the PSE or in newspapers. Minority shareholders generally do not have the insider connections within the company.

The general passivity of minority shareholders and the lack of a collective, cohesive voice against a dominant shareholder prompted some to establish a minority shareholders association along the lines of the Australian Shareholders' Association (ASA 2009) – an activist group that represents the interests of minority shareholders. The ASA has been active in scrutinising companies that have been less upfront about information, critical of the remuneration reports of several Australia companies and have contributed to an improved corporate governance environment. While the ASA does not claim to represent all minority shareholders, their influence is such now that their activism is regarded on the same level as a top ten institutional investor in the country (Matthews 2009).

The Minority Shareholders' Association of the Philippines (or MSAP) is nascently the ASA's equivalent.

“MSAP has been formed and incorporated with the SEC. Most incorporators are coming from the Management Association of the Philippines (MAP) in partnership with the Corporate Governance Institute of the Philippines (CGIP). One incorporator visited the Australian Shareholders Association in 2002.” – private sector 1

Other countries in the region have also been setting up this type of an association. In Malaysia, a minority shareholders group was given funding by the government to support its cause:

“In Malaysia, the government has given seed money to set up a shareholders' activist group. The government here has not sufficient funds.” - SEC

Promoting the rights of minority shareholders has been bolstered by at least the establishment of an organisation that would represent the cause of them. Nevertheless, it will be a challenge for the voice of a minority to go up against the dominance of one:

“There is a plan under MAP of establishing minority shareholders association. We need all that: minority shareholders, rating agencies. Get our own

independent rating. The majority (shareholder) is still the majority...The economic control of resources is in the hands of the few. The few dictate. It all depends on how it's employed. There are benefits to business, and can work against the minority. This can be good and can be bad.” – private sector 2

Nevertheless, it has received strong encouragement from the regulator:

“In three years’ time [I hope to see] more minority activism. The SEC will have to be strong on that.” – SEC

Having a minority activist group is evidence of changes that are slowly occurring and reforms happening in the Philippine corporate governance environment:

“MSAP is part of our advocacy now. It’s an uphill battle. The majority is still the majority. We still need to get the commitment of the majority. If you are not committed, to get commitment you have to get back to values – in government or in business. You must start from that.” – business advocate 2

The sophisticated institutional infrastructure that needs to be developed to complement the capital market is starting to take shape.

6.8.8 Foreign Investors

The other prominent group of minority investors are foreign investors. Unlike domestic retail investors, foreign investors generally are backed by strong and highly capitalised institutions. However, like domestic retail investors, they are passive, and not the shareholder activists that they are in their home countries.

Foreign capital market investment in the country reached new heights in the bull market of 2007 and they are a double-edged sword for the local capital market. However, foreign capital investment is generally seen as fickle and as hot money. Foreign investors may have the money and funding but they are not investing in the sectors where they can contribute to the development of the economy. For foreign direct investors, ownership restrictions prevent them from exercising much influence and activity, therefore relying much on the goodwill of their local partners.

The fickleness of foreign capital and their impact on developing economies is a source of debate. The unanswered question remains – how should foreign investment be managed

in the country so that it will be a positive force for improved private sector development rather than regressive economic development? (See also discussion in The Economist 2008b)

In this section, foreign investors mentioned by interviewees are large institutional investors such as pension funds. In Anglo-American corporate governance, institutional investor influence is high especially when it comes to the structure of the board. (Cadbury 2002: 106, 115) Foreign investors mentioned by my interviewees are from four different cultural orientations: Anglo-American (Australian, American, British); Germanic (Dutch, German, Swiss), Middle-East (Saudi) and Asian (Chinese, Japanese, Korean, Malaysian, Singaporean, Taiwanese) investors. The last group is increasing due to intra-regional trade.

The following relates how foreign investors are tentatively testing the waters of the Philippines and how they are viewed by the companies they have invested in.

6.8.8.1 Blue Chip Companies

Foreign investor participation in blue chip companies is present. On the stock market, the blue chips attract most of the foreign investment.

“We have 2000 shareholders, of which 16% are foreign investors from mainly US and Europe institutional funds that have satellite offices. The Asian funds are based in Singapore. [Our] market cap is USD5.5B. 16% owned by foreigners so that’s USD1.82B. We encourage [them to invest], make them appreciate what kind of a company we are. [That is] part of our wealth creation, to be able to realise the best value of our stock. There is a lot of goodwill in SM. 60-70% of SM trading value is from foreigners. There’s a big market cap and is the second biggest after PLDT. It’s very hard to sustain a [high] share price level [with the] domestic [investors] only.” – SM

“Ayala: it’s blue-chip. It’s the first choice in the Philippines as a partner for a foreign investor.” –private sector 1

“The companies worth investing in, their reputation is well known” –private sector 2

The blue chip companies are the most professionalised and widely seen as practising the

best form of corporate governance in the country.

“Is [corporate governance] happening in form and substance? There is plenty of form and size although substance is a long way off. There is a growing awareness of governance. There are pragmatic arguments as we are increasingly borderless. Capital is fungible. Investors favour entities that are more transparent.” – private sector 3

Blue chip companies are generally the first port of call for foreign investors entering the country.

6.8.8.2 Foreign Investors in the PSE

Foreign capital market investment was behind most of the volume and activity on the PSE in 2007 (Sanchez-Lacson 2007c). They move the market:

“It’s foreign investment that drives the market. On an average 70-80% of the total trading volume are due to foreign investors.” – stockbroker 1

“Foreign investment in the market is actually closer to 70%. The domestic market isn’t that developed, unfortunately, but we’re taking steps to remedy that and encourage local investors. For the market as a whole, it’s 55, 45%.” – PSE

Unlike domestic retail investors, foreign investors are very active in buying and selling parcels of shares on the stock exchange. However, the influx of foreign investors to the PSE was not positively received by all. The East Asian Crisis is a reminder of the fickleness of foreign capital inflows:

“Prior to the influence of foreign capital of the early 1990s, [the PSE] was rumour-driven. In the 1990s, the influence of institutional investors contrasted with smaller stockbrokers...In the mid-1990s, there were lots of foreign investors. Post-1997, they realised foreign investors were using language of ‘good governance’ different from locals, so there was more attention to quality research of companies. But the foreign investors were following the herd. The institutional investors pulled out in 1997, then came back after the crisis.” – academic

Foreign investors are seen as hot money and contributing to the volatility in the market. They leave as easily as they enter. As the PSE reached new highs, concern about the hot money coming into the country was palpable (Business Mirror 2007, Sanchez-Lacson

2007c-2007d, Remo 2007b):

“Overseas capital is very fickle, very opportunistic.” – private sector 1

“The PSE is not an indicator of the market. Better to attract foreign direct investment [instead of hot money]” – private sector 2

The indiscriminate flow of foreign capital to the stock exchange was also criticised as neither contributing to the development nor showing a substantial understanding of the dynamics of the economy:

“I see them as hot money. Not the kind of money we really need. It’s helpful to start the market now but hot money doesn’t love or hate the Philippines. Hot money goes wherever it thinks it can earn their profit for the moment. The owners of hot money see opportunity. It has ceased to a lesser degree. They’ll have to go to some place else. In and out, hot money over the last year. God help us if they start to sell, it won’t be absorbed by the local market and we will sharply depreciate.” –stockbroker

The Philippines, despite being out of rhythm with the region, is seen as part of East Asia. Therefore, investment in the Philippines forms part of the regional investment or emerging market portfolio of any foreign investor:

“[There is a] hierarchy created at the PSE– locals following rumours, not sophisticated information, not following corporate governance per se. Institutional investors follow sophisticated information – the Anglo-American corporate governance investor. Supposedly they are sophisticated. As for institutional investors, who really has power? Ordinary shareholders or fund managers in financial conglomerates? [But] why are [foreign investors] here in the first place? We’re in the region growing, potential and so forth. Not to do with sophisticated understanding of the economy.” –academic

“The financial markets [here] are emerging relative by the power of pension funds...They’re telling what gives liquidity and value to the stock markets. [The markets] need higher transparency.” –private sector 3

Foreign investment in the PSE will continue to influence the way the market movements in the country.

6.8.8.2.1 A British Hedge Fund Investor at the PSE

In 2007, a London-based hedge fund manager, GLG Partners, became a significant shareholder of the PSE guaranteeing them a board seat on the PSE board. They had bought the stake from the San Miguel pension fund, one of the largest pension funds in the country. This was the first case of a foreign institutional investor-hedge fund that had bought into the PSE (Sanchez-Lacson 2007e). For observers, the introduction of an Anglo-American investor to a board that is still dominated by insiders and brokers was an interesting event:

“GLG Partners LP was able to secure exemptive relief from the SEC to execute the transaction. By law no single person or entity can own more than 5% of the exchange...GLG will have only 1 seat and 1 vote, but at least its representative can help keep the discussions professional and may even impart and contribute whatever good experiences GLG may have experienced along the way.” – PSE

“[The] jury’s out on that significant minority investor. As hedge funds - caveat emptor. They may have taken a sophisticated take on their role. [They are] babes in the wood [here]. Governance practice [is different].” – private sector

Two years onwards, the hedge fund has not sold out of the PSE even during the peak of the global financial crisis. And far from being active, they have remained quite passive:

“GLG is still around though since they bought their shares in PSE they have done nothing significant, if at all.” - PSE

GLG Partners was acquired by another hedge fund in 2010.

6.8.8.3 Foreign Investors and Corporate Governance

While GLG has remained a passive institutional investor, other interviewees pointed out foreign investors were demanding improvements in the business environment. Foreign fund pressures are real and present and the regulators are well aware of this:

“(Question: I said there’s criticism of the OECD corporate governance principles because it’s from Anglo-American cultures and for developed countries.) That’s the most common complaint we get from covered corporations. Why enforce principles that are not adaptable to Asian/Filipino culture? It is not for Asian culture. But my response to that is, but we want foreign funds in our respective jurisdictions. We have to work along the lines of good corporate governance as

that's what investors expect. People, especially investors, hear a lot of good corporate governance so domestic corporations should follow suit. The foreign investors tell the domestic corporations they assess the company's corporate governance." – SEC

"[Foreign investor activism would be] a development I would welcome, if only to kick start best international practices and pure governance, protecting its investment and ensuring good ethical and business practice within the organisation." – PSE

Corporate governance is part of a foreign investor's checklist prior to making their investments. Foreign investors as catalyst for improved corporate governance in companies were a common sentiment. To attract foreign investment, practising corporate governance in substance is part of the criteria:

"There is nothing happening [in corporate governance], unless driven from the outside. If it's outside, it's interference for example from foreign investors." – private sector 2

"(Do foreign investors look at the corporate governance of the companies before they invest?) Very much so. Foreign investors look at corporate governance before they invest." -stockbroker

"We have realised it – we are isolated in the world. Globalisation is competitive internationally. Foreigners want corporate governance. They want disclosures. They want to be co-investors with owners to Filipino entities." – private sector 3

For business families, foreign investors can be more demanding than the domestic retail investors:

"Foreign Investors: they ask more in away, like who are the principals. Here the corporation reflects the principals. How serious are [the principals] on corporate governance?" – private sector 4

"The challengers to the families are foreign investors. Those calling more for good corporate governance are those who feel they're not given a fair share. Institutional investors coming in and the new players are challenging the

traditional large corporations which families control. Challenging those practices will benefit the new players.” – academic

From a company’s perspective, the foreign investor may have a substantial holding but does not represent the controlling owner. The following passage is a reflection of the regional variations in corporate governance practice and the cultural conflict between Eastern and Western standards. In this case, one Anglo-American investor demanded better disclosure practices from the company, while the company’s response was rather muted as the investor is an outsider:

“Before this interview, I got a call from an overseas fund manager based in London. We declared a big dividend and he was complaining to me for not telling them. He was emailing us and calling us frequently. He didn’t study the tax laws when he went to place the investment. We settled it and is now quite happy with the result and the solution he proposed. If a shareholder asks and comments, we reply to it promptly. At least they’re content. The UK fund manager – I couldn’t understand him with his accent. They had between USD500K to USD1M dividends so it was sizeable enough. But the shares are PCD nominated so he could have had multiple clients. There’s no institutional investor that can dictate. They don’t have that kind of shareholding. He said in Malaysia this was how things were run. He tries to compare different systems. He wants to apply the rules in different countries to us which isn’t possible.” – private sector 5

Demanding external investors have started challenging the insular nature of the business environment.

6.8.8.4 Communication with Foreign Investors

Similar to the interaction with domestic retail investors, larger companies normally have a formalised approach towards communicating with foreign investors through the use face-to-face presentations, investment roadshows and use of new technologies:

“The IR department serves the function of communicating with shareholders. We would have one on one with meetings, investment briefings, roadshows, teleconferences, email, and web services. Our annual reports are now much more investor friendly and we try to maintain a high level of transparency in the

publication. We are quite used to dealing with foreign investors and we have very good relationships with the large institutions. [We] satisfy [their] requirements through financial ratings and giving them an explanation.” – SM interviewee

“Foreign investors are normally invited to an investor relations meeting. There is an investor relations office. They go around in roadshows to inform foreign investors what’s going in the company. They are properly informed with plans of the company with respect to minority shareholders – our shares are publicly listed and they get their information from their brokers if they need to express any settlements. They can email/write to our investor relations unit.” – Ayala

“Our institutional investors include HSBC, Standard Chartered, ING, UBS, Citigroup. If they have any questions it goes straight to investor relations. There are also pension funds. Sometimes they ask if they can send a representative/observer to us.” – private sector 1

For companies that have listings overseas, the quarterly briefing is in line with Anglo-American practices:

“Manulife has a number of institutional and retail shareholders who reside outside of Canada. The rights of these shareholders are the same rights enjoyed by our Canadian shareholders. If they have any concerns, they can contact either Shareholders Services (for retail shareholders) or Investor Relations (for institutional shareholders). We make every effort to respond to questions in a timely manner.” – Manulife

“Communication with investors is with a briefing at the end of each quarter” - PLDT

Another outlet for communicating with foreign investors includes investor roadshows. For one medium-sized company, roadshows provide the opportunity for them to engage and be exposed to demands of foreign investors:

“We went to roadshows in Singapore and Hong Kong to tell them we are a company worth looking at. We faced institutional investors as to how much, who owns, as we are not known. We have foreign investors but we don’t know who they are as the shares are brought through a nominees account. There is a high

level of foreign shareholders. The roadshows are places where we can expose ourselves more to the institutional side. In the last few months, we have had a foreign investor come to us once a week.” –private sector 2

Philippine private sector companies with an international outlook are engaged in communicating with their foreign investors.

6.9 Stakeholders

In contrast to the shareholder value of the firm, the stakeholder view recognises the company as an interconnected, networked entity that has relationships with various organisations and individuals. The company has various stakeholders to whom it is reliant upon and equally, these stakeholders are reliant on the company. Stakeholders that were present in my nodes include banks, community, creditors, customers, depositors, employees, environment, external stakeholders, internal stakeholders, government, investors, media and shareholders.

In response to my question about the stakeholders of their company, two sets of responses emerged: the most immediate stakeholder is nominally the financial, majority shareholder; and the secondary which includes most non-financial stakeholders.

6.9.1 Primary Stakeholders

The financial stakeholders or the majority owners of the company are the primary stakeholders:

“Our stakeholders are shareholders, officers, depositors, creditors and the public at large. There are two tiers to our stakeholders – the real and intangible. The real or main stakeholders are the shareholders which is really the family due to their money and investment and depositors (lending and saving). Our intangible or secondary stakeholders in the broad sense it includes directors, officers due to personal interest, employees in general, and the public.” – bank

“Stakeholders: holding company 1, holding company 2 and the public.” –private sector 1

“[Stakeholders of the company are] majority shareholders, minority shareholders, employees, market and government for collecting tax. The primary responsibility

is to take care of the controlling owners. There's no choice. Responsibility and good corporate governance is about taking care of controlling shareholders.” – academic

Without doubt the primary stakeholder of the Philippine company is the owner or dominant family.

6.9.2 Secondary Stakeholders

The secondary stakeholders of a Philippine company largely depend on the industry or sector the company is in. For business groups, the stakeholders depend on the variety of businesses:

“[Our stakeholders include] outside shareholders, employees and customers. The banks [are stakeholders because they] provide funding for projects. For Ayala Land, the stakeholders are lot buyers, residents/condo owners, construction companies. For Globe Telecom it would be subscribers. At AC it would be shareholders, employees and banks. We also have a Stakeholders Relations Office previously known as the Public Relations office headed by the former cabinet member of government in the early years of GMA. The office is where creditors and suppliers can talk about their concerns.” – Ayala

“The majority stakeholders are the shareholders. Depending on which business – tenants for our malls, retail merchandising of a supplier. Banks – it's composed of lenders. For property it's developers.” – SM

One interviewee mentioned the importance of the supply chain in conceptualising the company's stakeholder relationships:

“Stakeholders upstream: customers, suppliers; stakeholders downstream: the industry, government, employees There are a lot of stakes upstream and downstream” – private sector 1

PLDT defines its stakeholders internally and externally as the following table shows:

Table 29: PLDT's Stakeholders

Internal Stakeholders	External Stakeholders
Shareholders	Government regulators
Investors	Suppliers
Employees	Customers
Officers	Subscriber

Government was also cited as a very important stakeholder in its regulatory and revenue capacity:

“The government is a heavy stakeholder. We pay taxes.” – private sector 2

Additionally, employees featured prominently as valued stakeholders of the company. Some employees also crossed over as shareholders of the company:

“A lot of our employees are shareholders as well. The employees subscribe directly to share offerings so they can say that they own part of the company. They usually own the minimum which is around 1000-3000 shares. Around 75% of our employees own shares.” – listed (4)

“(Who are Manulife’s major and minor stakeholders?) Example of stakeholders may include employees, the public, media, interest groups etc. Manulife’s stakeholders include our shareholders, customers, employees, distributors and governments where we do business. (What is the opinion of the company of its stakeholders?) We value all of our stakeholders.” – Manulife

For one company which has had problems in the past, its creditors are a prominent stakeholder;

“Benpres’ stakeholders are its stockholders, employees, regulatory agencies, affiliates and creditors. Benpres despite its failed investment and difficulties with the creditors, has been very transparent to all its stakeholders and in return have over the years continue to enjoy very strong support.” – Benpres

While for one business advocacy group, the main stakeholder is the business community:

“MAP has a good spread of stakeholders. It is the whole gamut of business. We are the leading management association and we cover all corporations.

Specifically on stakeholders they mainly are businesses.” – MAP

Having a good reputation amongst stakeholders transfers to the financial value of the company as well:

“In general, Aboitiz has a good reputation among its various stakeholders. We have a reputation for integrity, for social commitment, and for considering our people as our greatest resource.” – Aboitiz

“Way back in early 2006, we launched a bond offering amidst economic and political crises. The offering got a AAA rating. One Hong Kong publishing company made a comment that Ayala could do it because of its reputation despite the Philippine environment. Private companies are contributing to significant developments in the business community.”- Ayala

Good stakeholder relationships complement the shareholder value of the company. Together they form the aggregate value of a company.

6.10 Effects of ASEAN membership

The Philippines is a member country of the Association for South East Asian Nations (ASEAN). ASEAN is the largest free trade association in the Asia-Pacific region. The attitudes of the private sector in the Philippines towards greater intra-regional trade, integration and cooperation have been mostly positive:

“We feel it’s important to be part of the broader ASEAN community, and the way we intend to do that is by attracting partners from overseas. Secondly, we plan to invest with partners in these countries. We hope that that would blossom into relationships that can be cross-cultural in nature and encourage the flow of goods within the region.” Ayala Group CEO in de Borja (2005: 127)

Trade within ASEAN is increasing and foreign investors from the region are having an effect on the commercial landscape of the country. One interviewee mentioned that Asian foreign investors were less likely to demand transparency as opposed to their Western counterparts:

“For foreign ownership, look at the indices where foreign investors are: Europe, US, Australia. And look at other foreign investors: China, Taiwan, Korea – they

are somewhat lower down the scale. If they'll be major foreign investors, will they be as clean? The Asian Chambers of Commerce aren't interested in pursuing transparency as the Western ones." – private sector 1

The impact of ASEAN and intra-regional trade mean having common corporate governance standards are also gaining import through foreign investment pressures and there are moves towards harmonising such standards (in addition to IFRS and Basel II requirements):

"Because we've integrated too rapidly 58% of our trade is intra-regional. We are looking at – and compelled to harmonise attitudes...we are getting basically to recognise governance and understand corporate governance practices." – private sector 2

However, another interviewee spoke about the glacial pace of regional integration:

"We're part of the ASEAN group. We compete with India. For us to move to international standards there has to be a corridor of regional acceptance to move in that direction. We compete against each to be the first one to take the step. We can suffer. Unfortunately moving towards regional free trade will be gradual, and it can't be done quickly." – private sector 3

The rise of ASEAN is a counterweight to the US economic development model which was criticised by one interviewee:

"There was the apex of US influence and power in the economic model of 1950s, 1960s with the great middle class being built. We're talking about reversal now with the low Income disparity amongst ethnic minorities. We have learnt a lot from the Western development model but there are limitations. These very distinct limitations are:

- very capital intensive
- environmentally invasive
- socially disruptive

"My point is we really need a new paradigm. Development-inclusive growth, managing divides effectively. Yes to opening ownership limits caution different

levels of development. Take into account poverty levels, align investments with that.” – private sector 4

The above comment reinforces the view that unilateral acceptance of Western corporate governance standards is unwise not only for what it is seen to be representing, but also for what it is overlooking:

“If you’re looking at corporate governance practices, the weight of capital and the dynamics suggest we have to look to other points of view. In the old days CALPERS, Oregon, Ontario had lots of muscle. Now it pales to insignificant to the reserves of China, Japan and South Korea.” – private sector 5

The rise of East Asian investors reflects the progressive development of the investing countries. Indeed, the rise of sovereign wealth funds (SWF) such as Singapore’s Temasek, China’s Investment Corporation (CIC) and South Korea’s National Pension Service (NPS) signals their economic strength and all three SWFs have already made major investments in and outside the ASEAN region.

6.10.1 A Single Currency?

The prospect of moving towards a single currency, akin to the euro is not discouraged in the region. In a private dialogue with members of the Chinese bankers’ association⁵⁶, there is some support for a single currency unit. The EU experience saw the poorer countries of Europe receive infrastructure development funds from Brussels especially in the area of infrastructure. Exposure to the single European market accelerated the economic development, in particular, of Spain and Portugal. While the practical introduction of a single Asian currency unit is a long way off (especially with the fixed currency of the Chinese yuan), the possibility of its introduction is not remote:

“We need a regional currency in Asia which is strongly resisted by the USA [as regionally it is the] yen zone. Now it’s a yuan zone. However, the process has begun and it is irreversible, there will come a point where there must be agreement on economic standards to value.” – private sector

A single currency unit for the ASEAN region will be a catalyst for greater regional and economic integration though many administrative, political and economic obstacles are

⁵⁶ November 2009, Sydney

in the way for this to be reality anytime soon.

6.10.2 The Bridge Alliance: Telecommunications Cooperation in the ASEAN countries

The Bridge Alliance is symptomatic of greater regional cooperation. Its members are made up of mobile telecom operators from 11 countries. Established in 2004, this alliance covers mobile coverage for nearly 300 million people in the region. The following contains a screenshot of the website of the Bridge Alliance and its 11 operator members from the Asian region. The alliance comprises of Airtel (India), AIS (Thailand) CSL (Hong Kong), CTM (Macau), Globe (Philippines), Maxis (Malaysia), Optus (Australia, SingTel (Singapore), SK Telecom (South Korea), TaiwanMobile (Taiwan) and Telkomsel (Indonesia).

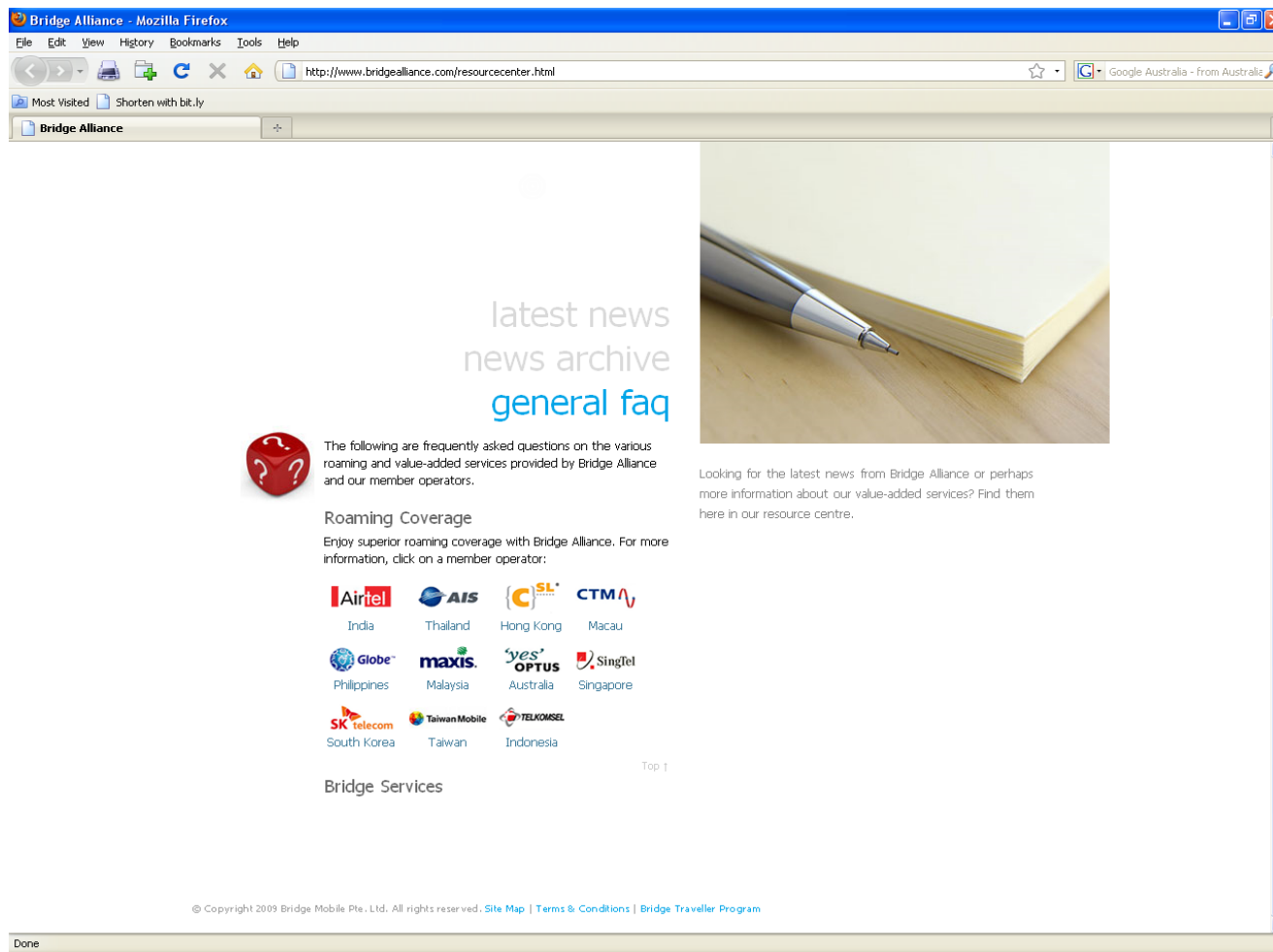


Exhibit 10: Screenshot of Bridge Alliance <http://www.bridgealliance.com/alliancemembers.html> accessed 12 December 2009

6.10.3 A New Group of Entrepreneurs: Korean Investment in the Philippines

As a sign of South Korea's economic prosperity and development, there is now substantial South Korean investment in the Philippines. Akin to Japan's investment two decades earlier, the increasing wealth of South Korea has seen the outflow of investment into other countries in the region. After the flight of middle class Filipinos and Overseas Filipino Workers (OFWs), there is a reverse migration occurring: Koreans are entering the not merely as tourists but as a new class of entrepreneurs serving the large expatriate Korean population in the country. Due to the historical legacy of the Japanese occupation of the Philippines, there is less the aggressive resentment of investment towards South Korean investors. (Zhao 2004: 114-115)

The presence of South Korean investors is a phenomenon of the rising middle class of that country. Being a richer and wealthier nation, being well-educated is a goal for some Koreans. Koreans first started coming to the Philippines because learning English was easier and cheaper to do in the country. This had a domino effect as services were provided for expatriate Koreans, and the Philippines' tropical climate made it an attractive and cheap tourism destination.

For one interviewee, the arrival of the Koreans is a sign of increased intra-regional investment but it may mean a less transparent way of doing business, as they are under the radar:

“There are many Koreans here as it's cheaper to learn English. There is a large enough community so it feeds on itself. There are around 400,000 of them here. They come here for English but the lifestyle is laidback and it's cheaper here. Taiwan is also a big investor. They are reasonably clean [in their own countries]. Whether they want to be clean in the Philippines is another matter.” – private sector 1

The Koreans in the Philippines are entrepreneurs and are bringing in long-awaited investment into the country. There is tension between the locals and this new entrepreneurial class as the former adjusts to the economic power of the latter.

“The Koreans are coming in silently and slowly although there is now Philippine money coming from expatriate Philippine entrepreneurs investing into the

country.” – GSIS

The perception of the secretiveness of Korean investment coming into the country was commented upon by one regulator. Issues facing this regulator include their contribution to the informal market, flouting of migration laws and monitoring issues (Cabreza & Moulic 2007, Quimpo-Espino 2007). The Koreans seem to have quickly caught the locals’ penchant for avoiding formal institutions and regulations:

“The Department of Affairs have granted 67,000 resident visas to Korean nationals however there’s 200,000 of them here. Every corner now there is a little Korean store. At the end of the day, Koreans bring P65B worth of investment into the Philippines. The genuine figure is probably P100B [but there’s no administrative evidence of that]. The Koreans here are mostly in the retail trade and are on the grey side or indifferent section of the law. They are skirting our migration laws and are quite hidden. It is a major problem for us in monitoring. How do you monitor if they’re not complying? If they’re under the radar, you can’t find them.” -SEC

Ironically, out of all the East Asian countries that experienced the crisis, it was the Koreans that made the most fundamental changes in their corporate governance system such as breaking up the power of their *chaebols* and imposing corporate governance reforms unilaterally. Their corporate governance reforms in the aftermath of the East Asian crisis shook the foundations of the business establishment in that country:

“Korea had a choice – they could have done due ready adjustments or avoided things. But they needed - no - they wanted to change. They did not just satisfy the international norms, they went beyond that. They did not just want to be better but be the best [in corporate governance practice]. They put you in jail if you flout corporate laws. The attitude is there. They are targeting higher forms of corporate governance and targeting the best. Here, we’re trying not to be the worst, and not to be in the last place [in terms of corporate governance]. If you compare across countries, Korea has done most in its corporate governance reforms.” –private sector 2

Korean investment is looked upon ambivalently in the Philippines. There is still a great deal of uncertainty on whether this type of investment will contribute to positive and

sustainable economic development of the country.

6.10.4 Deterring Foreign Investment

The ambivalence towards foreign investment is partly historical and partly cultural. As a colonised country for nearly 500 years, exploitation of the country by foreigners does loom indelibly in the psyche of the Filipino. Both Spanish imperialists and American colonialists have left a nationalistic almost xenophobic attitude towards foreigners. Similar to the experience of a former colony and another great democracy, India, restrictions on foreign ownership left the country in a protectionist dome. Import-substitution policies instituted since the end of World War Two protected local industries leaving them uncompetitive once certain markets collapsed or were opened. Protected sectors remain politicised and highly lobbied for by certain business groups:

“It’s hard to be competitive here. We can’t do that, that’s the difference. If you’re going to attract foreign investment, it’s down to the 40:60 principle. The PSE agrees with this but [certain] families don’t want [liberalisation] to happen...they control the Philippines. There are political strings happening...There are vested interests of the families that control the economy and politics.” - private sector 1

Not surprisingly, despite the interest foreign investors are showing in the country, there is some way to go before it can attract the same amount of foreign investment of other countries in the region:

“According to the US Chamber of Commerce, the bureaucracy is difficult. This comes from foreign businesses. One of the challenges is the process of establishing business in the Philippines to go through. A long the way, foreign investors get confused.” -private sector 2

While there are Australian mining companies and at least one Australian bank has a presence in the country, Australian pension funds aren’t investing in the Philippines as the country is not an attractive destination for conservative funds, compared to their speculative peers:

“Australia is investing on its own market rather than looking at other countries. Aussie superannuation funds are not here investing.” - stockbroker

At a monthly membership meeting of the Australian and New Zealand Chamber of Commerce in Manila, one foreign investor told the Finance Minister about aspects of the Philippine environment that were making business conditions difficult:

Foreign Investors: I am an investor in the UK and UAE. I have recently come here. There is an incredible capacity to make it difficult to do business here. Is there a service of encouraging foreign ownership? It's not like Dubai where there are tax opportunities that create new businesses. Difficulties here are apparent. There are opportunities and hope that one is transparent with start-ups. My hope is that [all investors] are treated even-handedly as in Dubai, and that all rules become apparent. How would you encourage foreign investment so it creates openness, understanding, transparency and a consistent application of laws?

Minister Teves We are struggling with those issues and parameters. Compared with other countries we are not doing too well. There is increased foreign ownership and we continuously work in parameters. These issues you mention affect increased investment. It is important the element of openness, transparency and consistency, without them we cannot expect too many investment to come in especially with long-term, large investors. Hopefully in time we will see more trade and to reduce red tape with a gradual climate for investing. The macroeconomics is essential such as fundamental investment in infrastructure and to encourage more long-term FDI." ANZCHAM July 2007 meeting

Opacity in the country's business environment and protectionism of certain Philippine industrial sectors has deterred further investment in the country.

6.10.5 Foreign Ownership Controls

There are foreign ownership restrictions in certain sectors and limits in the percentage of foreign ownership of listed companies:

"In the stock trading system there is the Philippine Depository Receipts who are owned by non-Filipinos but we are not sure who the owners are (20%). We ask for disclosure on private ownership as the foreign limit is 40% and we will get penalised if we go over that."-listed company 1

“There is a shift of foreign investors into AC. But there is a foreign ownership limitation. No more than 40% of AC should be owned by foreign investors as real estate must be owned by Filipino citizens. We are looking forward to revisit the proportion so foreign investors can go beyond the limit.” – Ayala

“There is an increased liquidity [in the trading of a bank when] foreign investors [buy in]. [However there is a] 40% ownership [limit for them] in a listed bank. There’s a force to push, to slacken that limit and increase the foreign investor base, and also institutional investors.” – listed company 2

One interviewee mentioned how the majority owner, a foreigner, did not accumulate the same voting rights:

“We have a majority economic interest in the listed company. If you go back to the annual report, there is a high majority interest in the company. But the voting interest is below 40% because of the 40:60 principle. The majority holder is a foreigner so you can’t have more than 40% voting rights.” – foreign company

However, there is lobbying to remove the protectionist barriers in infrastructure sectors in order to increase competition, attract investment and new technologies:

“We don’t have as good a road system, aviation is protected. [Protectionism] is not creating jobs. These are macroeconomic issues. We need more openness, more competition. We are still in the Middle Ages. Industries are protected. Competition will bring more technology, relying on performance by foreign investors. If there’s competition here, we become more efficient, it raises the labour skills, and creates a virtuous cycle.

“What is the point of forcing [foreign investors] to bring technology? What incentive is there to become more efficient if they’re protected by being the lowest risk and they do not bring the most updated technology). How can government force them to comply? There are recent incentives in industries in the national resources but it is not helpful. Our position is to take [that clause] out of the constitution (incentives to invest) and to get rid of restrictions and the limit on foreign ownership as well to determine in the legislation what can be owned by foreign investors. We need to create jobs. The limit on foreign

investment and ownership is not conducive for foreign investment.” – Makati Business Club

In the case of the telecoms sector of the country, once barriers were removed, the oppressive weight of protectionism gave way to a flourish of entrepreneurialism. This not only benefited the former monopoly PLDT:

“After [former President] Ramos broke up the telecommunications monopoly, the talent of the Philippine people began to shine. The Philippines has famously become the text-messaging capital of the world—and even PLDT, the former monopoly, has learned to compete. Today, the profitable company, run by professional executives, is in the growth portfolios of sophisticated investors around the world.” (Rushford 2009)

But consumers as well:

“Since the telecoms monopoly break-up, 20M people or more have cell (mobile) phones. 5M people have landline. [The industry has] grown since they’ve broken up the telecoms monopoly. It’s a growth industry⁵⁷...The Philippines has well-trained, well-educated people – we know what has to be done. We have booty capitalism (Hutchison) here: a few rich families, entranced our politicians keeping the law tailored to favour them. We have to break up their monopoly over power.” – private sector 1

The basis for foreign ownership restrictions is set out in the post-Marcos constitution. For foreign ownership limitations to be altered, the constitution needs to be amended and amending the Constitution is a challenge:

“For foreign investors there is the fundamental question of the 1987 constitution which would allow the private sector to come back.” – consultant

One regulator was not convinced that lifting investment restrictions will guarantee more

⁵⁷ The telecommunications arms of some business groups may also come under threat from disruptive, new technology: “But for the foreign market. I can count on the number on my fingers how many [companies from a foreign investor’s perspective] are worth buying into. On the other hand, I am not an expert. PLDT, Globe have to reinvent themselves. There’s the threat of through the internet – the minutes would be a lot cheaper. Smart has a lot of users of cellphones, not too many landlines. People use the phone or text due to the non-availability of infrastructure. VOIP is a threat to them. We don’t have inventors, who’d look at this market.” – private sector

foreign investment across all sectors but admitted it had the intended effect in the resources sector:

“What makes a direct relationship to lift restrictions mean foreign investment will come in? It doesn’t mean necessarily foreign investment will come in. There is that situation in the mining sector which fits the equation: lift the rules; they come in.” – regulator

The issue of majority ownership does come down to a matter of control. Where the investor does not have control of the investment even though most of the funding comes from the investor, not having that control deters investment.

6.10.6 Improving the Pool of Domestic Investors

Due to the ambivalence towards foreign investment, others have suggested encouraging domestic investment so there would be less reliance on external capital. While foreign investment in the capital market is tolerated, local investors would be more welcome as the money would be from domestic participants. There is a perception that local investors would not move the money out of the country as a large foreign institutional investor would. Whereas a foreign institutional investor would see the Philippines as part of a basket of investable funds generated for an East Asian fund, the money invested by locals would be deemed more patriotic, supporting national champions:

“[Local money] is beginning to be more available for the stock market. In the next 10-20 years, hopefully, the market [will have] much more a proportion of local money.” – stockbroker 1

“We have to educate our people. Give courses in college now about stock market. Educate more people to invest and make investments. Some in real estate, manufacturing, stock market etc. Make [local money] dominant so it becomes 75:25 (local: hot). We don’t have to worry about that money running away. The money made here, stays here. Hot money is in and out. No more profit to be made.” - stockbroker 2

Educating local investors about the risks and rewards of the capital markets comes down to a greater awareness of financial instruments and improving financial literacy. For

domestic investors who bought into the privatisation of Petron, the pendulum of the share price movements left some of them with an unsatisfactory experience:

“We (retail investors) all knew how to buy, but we didn’t know how to sell. We watched the share price go up and down. We didn’t get to sell the shares. Retail investors were new to the money trade.” – Petron shareholder

The sometimes speculative and volatile nature of the share market requires greater explanation as one fund stated:

“[It] must be explained why this is thus, why your investment [moves erratically]. There is a lack of [investor] understanding [in the country].” -GSIS

Regulators acknowledged the dearth of knowledge in this area. However, there is some progress with a couple of initiatives being undertaken. One initiative includes educating students about the capital market with an MOU between the PSE and universities (Business Mirror 2007b). Another includes improving the financial literacy of the population through the banking system:

“We are promoting financial literacy amongst depositors. Consumers are just used to traditional deposits. Other banking products are not well known. We hope to promote certain amount of financial literacy in coordination with the SEC, IC, an NGO called EPRA (based at Ateneo). This is also an issue with the Financial Sector Forum, starting with the school children.” - BSP

Nevertheless, there is a long way to go to encourage domestic investment participation and to improve the financial literacy of the population.

6.11 Rise of China

My interview questionnaire had a section on China and I aimed to find out what the growth of China meant for the future of business in the Philippines. China’s emergence impacts each country in her vicinity as the balance of power and trade alters to accommodate her rise and influence. This process of transition is occurring and is symptomatic of the rise of this country’s growth as the world’s economic centre moves

from the USA to China⁵⁸. The impact of China on the Philippines and the region is enormous.

Where arguably Filipino-Chinese business families have a distinct advantage compared to other business groups is the opportunities that present themselves with an emerging China. Knowing the language, cultural norms, cultivating familial and civil relationships and sharing similar ethnic origins possibly gives them an insider's view of the country. As China opens up, its diaspora is reciprocating with "governments increasingly see their ethnic-Chinese populations as assets rather than threats." (The Economist 2008c):

"In the Philippine economy, the business climate here is very Chinese. There are a lot of [Chinese] migrants [here]...The Philippines can be fantastic outlet for China. The Philippines is ready made. China's already here." – regulator

Some business groups have already established commercial entities in mainland China. The rise of China, in general, was mostly seen in a favourable, albeit cautious, light by most interviewees.⁵⁹ China's growth and economic power in the region and in the world is undeniable:

"We see it as the next superpower. There is no stopping it. It offers all so many opportunities." –private sector 1

This section looks at how business groups see China, China's corporate governance, how China's rise will impact Philippine businesses, the Philippine economy and geopolitics of the region; and the successes and pitfalls greater interaction with the mighty power in the immediate west of the country brings.

6.11.1 Business Groups in China

Several of my interviewees have expanded into China. For the Philippines' largest mall operator, the founder was born in China and there are strong emotional links to his country of birth. This link has translated into building malls in China though they are located in provinces where there is less competition. Oft-repeated amongst my

⁵⁸Other moves by multinationals such as by the global bank HSBC to move the principal office of the CEO from London to Hong Kong is but one of many activities that chart their readiness to take opportunities of the market and the region. See Cheng & Poon (2009).

⁵⁹ This concurred with most press coverage during my fieldwork with government supportive of more links with china. However, my fieldwork ended just prior to the NBN contract scandal. See the following for NBN articles. See Dizon (2007) and Balaba (2007)

interviewees who have expanded into China is the potential market size as the middle class grows in the country:

“[The holding company] is not in China but the family has another financial vehicle which finances their own malls in China. It’s not a joint venture. It is privately owned. There are malls in Xiamen, Chengdu. It was established there 5, 6 years ago. There are affiliations and opportunities.

“China will be a power. It will continue to grow. We will have malls there but not in Shanghai or in Beijing. These two cities are already crowded. If there’s opportunity [it will be in the provinces]. The Philippines has a population of 87 million. That is the population of one province in China. There are 22 provinces. In Chengdu, we have a third mall, very similar to Metro Manila. We have 16 malls in Metro Manila. They are profitable malls. The mall in Chengdu we are doing studies, the demographics are different and the land values are different where we can’t own land, we can’t lease; time is 25 to 30 years. The next 10 years is leasehold. The Chengdu mall is a medium sized mall. It is one third the size of North EDSA. The Mall of Asia is the third biggest after China. We have the 4th biggest in SM Mall EDSA and the 5th with MegaMall. China is building bigger malls than what we have. They are Chinese owned.

“We go to smaller cities so we don’t get the same competition. We are not looking at other countries outside of China. China is close to the Philippines...Whatever you need will be made in China. This will happen in the next few years. The biggest province in China [is bigger than the Philippines population]. SM has 60,000 employees the government has over a million. We hire locals [in China]. Only the top level executives are Filipinos. (My interviewee makes a call to China inquiring about the population of a province)” – SM

For Metrobank, the founder has also personal ties to China and the bank has expanded into China. Unlike SM, it has established a branch in the competitive, highly commercialised city, and the most international of all Chinese cities: Shanghai. The bank is competing against other international banks that have set up in the country. The bank sees its expansion as facilitating business transactions in the Philippine-China trade:

“We have now a branch in Shanghai. We are the only Filipino bank there. We are converting it into a foreign-owned branch. It is a regular Chinese branch but foreign-owned. The Articles of Association prepared by the Chinese lawyer have already corporate governance conditions (my interviewee takes out article). On China’s connective transaction there must be a controlled committee regarding how much directors can borrow from the company. Modern Chinese corporate governance has adapted to global standards theoretically.

“If we expand in China, it will be in Shanghai and the surrounds. The business will be at least double of the entire business we have in the Philippines and it has tremendous potential. I was asked to lecture to Oushi, a maker of crackers and candies. They are based in Shanghai. They are expanding like the rays of the sun which gives credence [to establishing there]. [If successful] our business in China will double. [Other foreign banks] are present, undergoing conversion to meet regulatory requirements. Standard Chartered are partly in situ...In Shanghai, the buildings have mushroomed...[We want to] attract the business of the Chinese who have connections in the Philippines.” – Metrobank

Banking is crucial to international trade and this sector is necessary to facilitate business transactions between the two countries. Some harmonisation in corporate governance practices in both countries at some point in the future could also be one result of greater interaction in the banking system:

“A lot of large banks in the Philippines are owned by Chinese families. Allied Bank - Lucio Tan, BDO – Henry Sy, RCBC – Yuchengco, Mr Tan, Mr. Sy and Mr Gokongwei have business interests in China. Business with China would forward the way of banks. Banks must have correspondent relationships. Progress of corporate governance in China could [have an] effect and be supportive of what’s happening in the Philippines.” -BSP

International companies with subsidiaries in both the Philippines and China are able to compare and contrast the way of doing business. Restrictive ownership in the Philippines is the compelling difference between the two countries:

“There is a lot of investment in China in the last 10 years. There’s a big difference between China’s way of doing business and the Philippine way of doing business.

When we started business in China, they were very concerned that we were foreign investors as we were involved in what they'd term as strategic. When I first started, foreign investors could own less than 50% (shareholding). But now, China realised we bring value and are not a threat so they allow a 60-70% (majority shareholding) with the government SOE as a joint venture partner. The biggest hindrance is in terms of the vetting up back to the 40:60 principles. We can only get a 40% foreign ownership here. Things have shut down here and moved to China." – private sector

"Manulife operates in China through Manulife-Sinochem Life Insurance Co. Ltd, a joint venture company between Manulife (International) Limited (51 per cent) and China Foreign Economic and Trade Trust & Investment Company, a member of the Sinochem group (49 per cent). China's fast growing is stimulating the growth of most of the countries in the Asia, including the Philippines. Manulife has an optimistic view on investment in the Asian region." – Manulife

China's business environment currently is more accommodative, agreeable and less of a struggle than in the Philippines.

6.11.2 As Part of the Chinese Supply Chain

The subservient, and sometime pessimistic, outlook of the country to the economic giant was present with most interviewees seeing as part of China's supply chain especially in the provision of raw materials:

"The Philippines would be a supplier to China in some form or another. The Philippines can't compete. We have to find our niche. There are currently a lot of questions regarding these investments signed with China to set up new agricultural business. We'll be suppliers and compete in certain industries. Some [would look at us because of the advantage of speaking] English and so on but the number of Chinese students learning English – English as a [Filipino competitive advantage will be no more]. At the end of the day, it is the drive of the work ethic of China that will make us suppliers to that country." – private sector 1

"[We are part of] the supply chain, [and we need to find] our niche in the supply

chain. China plays a big role in the supply chain. A growing China will result in greater in Philippine economic development. The danger is if [China] turns inwards. Now, they're growing big by exporting to the US but they have a big internal market and as the market grows prosperous, [they] may now produce instead for their own market. They are producing for the export market, as the international market, [eventually] they'd start selling to themselves [although that's] still a long way off. In the meantime, we're going with them." – private sector 2

Like other countries, manufacturing in the Philippines has been hit hard by the rise of China. Production has migrated there and this situation is not likely to change in the near future. Producing goods in China is seen as more cost effective than in the Philippines and the country is no match for the efficiencies of Chinese manufacturers:

"Almost everything these days is Made in China. China is having a big impact on the Philippines." – public sector 1

"China has an enormous impact on the Philippines. Previously the country had a cheap manufacturing base. Many of the manufacturing bases have now moved to China itself." – private sector 1

"China's economic impact is so strong we can't compete with China for example in the manufacturing sector. In the steel industry, the demand for steel is growing. Plastic resin, plastics industry, garments, smuggled plastics resin is going to China." – private sector 2

"We feel that a growing China is good for the global economy as a whole. As for the Philippines, unfortunately, we have seen a lot of manufacturing businesses exit the Philippines to move to China where they can produce at lower costs. At the same time, China is becoming a very large market for the Philippines for certain products and services. Agricultural and mineral exports are a good example." –private sector 3

Labour costs in the Philippines are far too high, and the unreliable infrastructure in the country makes the country uncompetitive relative to China:

“Basically [China’s growth] is affecting local industries as labour is cheap in China. Even here, there are a lot of Chinese items available locally. It’s all about globalisation. All are affected indirectly; the Chinese economy is affecting Hong Kong where a lot of OFWs are.” – public sector 2

“[If you look at] manufacturing labour costs, China, Vietnam and India have proved to have lower costs dramatically. Labour is a significant cost [here] and electricity [prices] is high.” – consultant

However, the upskilling of Chinese labour could increase that cost:

“[China is] very competitive in the pricing. I’m not too scared for now. The Chinese are getting more expensive because their highly skilled workers are much in demand.” – private sector 4

Several interviewees mentioned the enormous consumption of resources by China to fund its manufacture-led economic growth and how this has a positive effect on resource-rich countries such as the Philippines:

“What are particular things Philippines can export to China? Tropical goods. The Philippines has rich minerals such as nickel, copper.” – private sector 5

“[The] effect [of China] is like a ripple in the pond. In the Philippines it will increase in the mining sector, [and increase the] mineral output.” – private sector 6

“China is investing in Africa. China wants to tap into the resources here. [The country is an] energy consuming machine, not driven by ROI... As competition for natural resources increase, [things will] become more difficult.” – private sector 7

Chinese reliance on natural resources is persistent and its energy needs for industry will continue in the foreseeable future. Geopolitically, there have already been tensions over this reliance with supplier countries.⁶⁰

⁶⁰ Indeed the competition for natural resources and for China to secure its future energy needs was highlighted with the debacle over Chinalco’s attempts to buy the coal reserves of Anglo-Australian mining company Rio Tinto and the jailing of four Rio Tinto executives for corruption was widely seen as a retaliatory move after the deal fell through (see Verrender 2010).

6.11.3 Corporate Governance and China

My interview questionnaire also asked about the impact of China on corporate governance in the Philippines. For example, one Chinese corporate governance reform requires 50% of its company boards be comprised of independent directors, far greater than the 20% requirement in the Philippines. The most articulate response I received on the effects of China's implementation of corporate governance came from my ICD interviewee. His rumination covers the impact of Chinese corporate governance on business families, the enforcement of rules and regulations, and the central coordinating role of the Chinese government:

"FDI is going to China not because of its better governance practices. It is all other things than governance. China has greater governance challenges than the Philippines. The impact of the emergence of China on the Philippines is not direct. We talk about FDI – China has other things to offer. China seems to have a plan. They have a plan and are more serious in executing this plan and it is government related.

"If and when in form and substance there is a market environment in China but I know for a fact that there is a concerted effort by the Chinese government to improve corporate governance level of China and this may have an effect. I would like to say if and when corporate governance arrives in China – there is a status quo in the Philippines. We are in Asia, governance is a concept from the West. Last time I looked at China and saw what it is doing. We're now losing on number of things of governance. There will be an impact if they (the Chinese) improve their governance practices and that will be an issue for the Philippines. We use the improvement of China as leverage to tell companies here to improve corporate governance.

"The attention of the companies is that they look at what China has done and the Chinese have a plan. In the Philippines there is no central point. Society is so fragmented and I say this on the policy level and not because I am at all being unpatriotic. We are aware of governance developments. The myth of China (i.e. economy booms on the coast but not the interior), but for all its worth, looking at whatever we could observe, we want to capitalise upon it.

“For Filipino Chinese, I feel that we have heard about corporate governance in China when they do this not to say when they hear about the process in China. Guanxi, relationships still dominate in China. What part of that is corporate governance? Corporate governance is relatively new, there are government related moves in regulatory authorities. In China, the country requires 50% of the board be composed of independent directors, in the Philippines it is 20%. In Hong Kong and Korea it is 40%. But of course is it 50% in reality? The Philippines is more open than China.”– ICD

Enforceability of rules and regulations in China was echoed by several others. Chinese law allows for capital punishment of white collar criminals is a deterrent to engage in wider malfeasance. This penalty is a strong incentive for greater compliance by companies:

“If you look at China as a growing economy, you can enter the market and predict what will happen. Rules are clean, well-defended such as the number of board seats. Violations are punished in a draconian way. If you’re corrupt, you’re shot. Here, when you’ve done so (corruptly), you get away scot-free “ – private sector 1

The command economy of China also means reforms are quickly implemented:

“In a way, the system they have in China allows quicker reforms if they want to. For example, rules requiring to have listed companies to have independent directors. In the Philippines the minimum requirement is 2. In China it’s now about 50% of board seats. You must do it here in the Philippines. But the Philippines has more freedom and there is more debate here.” – private sector 2

China’s form of corporate governance is shaped internally to suit its local conditions, and also externally through participation in regional forums on corporate governance:

“China is socialist with capitalism thrown in. If [China] wants to institute corporate governance, they can do it more quickly. I’m not sure if they’re completely convinced [about corporate governance]. Corporate governance is a capitalist complex, not sure if they can put that into the system. We get to interact with them through the East Asian Institute of Directors. China joins us.” – private sector 3

“There are corporate directors’ regional meetings attended by China. China has still a fledging culture of corporate governance. China has own home-grown initiatives where 50% of boards must have independent directors. You’d better prepare and comply as there is a strong power of government. It’s harder not to comply. China is a command economy.” –private sector 4

China’s corporate governance practices take a different form to the Western model::

“The logic for corporate governance is to be investor friendly. In China, with independent directors – how independent are they? China, Vietnam. They are planned economies on being founded as they are covered. [China does] not respond to Western corporate governance practices. It’s to do with *realpolitik*. – private sector 5

However, most interviewees were not convinced that the Chinese form of corporate governance would have an impact on the Philippines:

“The impact of China is not so critical on the Philippines compared to other Western counterparts. In the Philippines, Circular II is not as structured as SOX. SOX s.906 is on the criminal liabilities of CEOs. In the Philippines there is no such equivalent. There is the Penal and Corporate Code, there is some non-compliance penalties but it does not have far-reaching jurisdiction. There is no Foreign Corrupt Practices Act. There is not much of an impact. It would be good if China practices corporate governance. There is an Asian Conference for Internal Auditors. The quandary is applying Western practices in an Oriental context the same way Western companies are adjusting to the practices in China.” – IIA

“[China’s growth] is going to affect every economy. The effect on the Philippines will be similar as in everywhere else. It’s nothing unique. [However, China’s growth] won’t change corporate governance. Will it affect Filipino investors in China? Foreigners can be as bad as Filipinos can be as good abroad. Filipino companies can adapt to the structure in China. Whether Filipinos will change, I doubt it.” – academic

Chinese corporate governance practices take greater import when they do business internationally especially in a developing economy like the Philippines. There was a

strong sentiment amongst interviewees that Chinese firms ought to practice good corporate governance and behave in an ethical manner or there will be regrets and disappointments on both sides. This perhaps reflects the lack of trust in the process of government contracts and tendering in the Philippines:

“Westerners are usually upfront on the surface. There are big questions on contracts with the Chinese. There has been no open bidding and it’s more agricultural based. The government is prepared to give up a lot of land for China to come here and set up entities for export: fisheries, land. They are projects that are supply driven that they set up with the government. The government is giving up government land, orchestrating, purchasing and expropriating more land for these projects.” – private sector 6

During my field trip, there were covert deals made between the government with Chinese firms in the telecoms industry (see Chapter 9: Corruption – NBN) and the agricultural sector (Reuters 2007 and BTN 2007). Opacity in the tender processes undermined trust and confidence. Several interviewees suggested these cases may have a long-term detrimental effect on the Philippine business environment if the covertness of these deals continues:

“The rise of China and its effect on the Philippine economy through infrastructure, railroads and telecom contracts – it would be good for us if they practice good corporate governance. If they don’t, we’ll pay for it...We’d prefer to trade and to practise good corporate governance (with partners) who practice good corporate governance. That is key to global competitiveness. In an IMD Global Report, there were 7 criteria on corporate governance. It’d benefit us if China will reform itself and if they practice corporate governance.” – private sector 7

“Long term I am very concerned about China. China will establish a hegemony in Asia if it’s not doing so already. Japan is the second largest economy in the world which China will soon overtake. China has to learn to be more socially responsible. China is far too much money oriented at the expense of doing anything else. There are three questionable contracts [here], large amount of bribe money paid to local government officials. If America does that, the locals go to jail. I’m worried that we’ll see more of that. [This is] not what the country

really needs. If China grows, will we be part of a major part of the economy? Will we be part of this dominant culture?” – private sector 8

Well-governed Chinese companies that invest in the Philippines will contribute best to helping the impoverished country develop economically.

6.11.4 China and ASEAN

As the giant that dwarfs other countries in the region, China’s economic superpower status emitted opinions of enthusiasm, ambivalence and trepidation. Positive views on China were mostly based on the economic angle such as its role in stimulating the region to recover from the East Asian crisis, contribution to increased world trade, and by making a substantial input to the role and future of greater regional trade and cooperation through ASEAN:

“In 2004, things were getting better, dollar debt in corporate value shares, more restricted. Banks found buyers from non-performing loans. Currency picked up in 2004, then commodities in 2005. For Indonesia, the commodities took them out of the crisis. China was also growing strongly. China helped, and she began to take (the rest of Asia) out of the slump.” – stockbroker

“China will help the Philippines. China is contributing to the world with low inflation everywhere. Trade benefits all participants.” – private sector 1

“China, and to a lesser extent, India are the 800 pound gorillas. Down the pipeline, India’s coming on board.” – private sector 2

China’s reserves were also highlighted as a sign of her economic strength and source of influence:

“There is a whole notion of Asian response which is ambivalent in many respects. We have to put that in the context of how we are seeing the centre of gravity of the world shifting from the West to the new Asia: ASEAN + 3 (the three is China, Japan, South Korea). The region that now accounts for half of the world’s population, in excess of global net reserves. There are proposals where growth from the region would exceed the OECD countries by 100%. This is the region that substantially finances the US deficit.” – investment banker

“Japan has become the major investor [in the region] and provided development assistance. China is not at that level yet. There are challenges for China in areas of government requirements, corporate governance, public lending. China is sitting on reserves and will heavily influence its neighbours.” – private sector 4

“China has produced a rapid transition. But there are still the inequalities between the coastal vs. interior. China has accumulated huge surpluses and is a major investment behemoth which will influence behaviour.” – private sector 5

Like Japan a quarter of a century earlier, some interviewees expressed the view China could take some leadership role and invest regionally:

“China has become the dynamo of the region. China exports to the West. This is the interval growth of China and it is going to be a dynamo like US or Japan was in the region. [The challenge would be] sustainability over high term. It is a competitor to the Philippines in garments and China is actually exporting more and growing.” – private sector 6

“The best way to look at it is not as a threat but as an opportunity. Eventually, [China] would have to invest in other countries such as Japan previously. China could be a catalyst in the region as Japan did decades ago. It’s inevitable and the US has to adjust to an economically powerful China.” – private sector 7

If China is to have good relations within the region, strong arguments were made for China’s wider participation and greater cooperation with ASEAN:

“From a regional perspective, on a macro-level: the political economy perspective is that the ASEAN group is coming up well with a Free Trade Area along the lines of the European Union. China is a mass market, member-countries will face a large potential market.” – regulator 1

“We’re working with our ASEAN neighbours – to be one trading group and dialogue with China, to be one group with Japan. When these things happen, we can become a trading bloc (ASEAN agreement with China, then ASEAN agreement with Japan). So we can compete as a trading bloc with US and Europe.” – private sector 8

“We see [China] as a good sense of diversification as we have heavy reliance on

two trading partners: US and Japan. There is now a renaissance in East Asia. The World Bank looked at this study as a new phenomenon: Middle-income countries trading with each other (ASEAN) and China. This is a new phase, not just big and small countries trading with one another.” –private sector 9

Ambivalence on China’s impact was largely based on issues of equality and democracy. Interviewees expressed hope that China would exercise its economic power in a responsible manner:

“China is a young power. They’ll cooperate more closely with the other powers and the Philippines will benefit from the competition. One hopes it does not transfer and get captured by a few. That there is something left for most of us.” – private sector 8

”When China gets angry with Taiwan, that’s going to cause a political struggle for support for and against in the region” – regulator 2

“It’s a good thing for [China] to grow. Hopefully, [they would] have a lot of wisdom to develop that growth. They are under pressure from the G8 to open up completely and democratically.” – private sector 9

“Worldwide there’s an anxiety of China being an economic superpower. For the next decade, we hope China would consider the Asian countries as little brothers and not impose its own will on Asian countries. We’d like to see China take the lead the way Japan has. Big nations like China, US, Europe, look at the interest of developing countries in the world. Anything you see in the US is made in China. Everybody would be concerned with the extent of influence generated as a superpower.” –private sector 10

In 2008, the first trilateral summit between the three biggest economies in the region – China, Japan and South Korea – was held in response to the global financial crisis and in attempts for greater regional competition. The summit was a strongly symbolic event and did not include a significant Western power. Political differences and historical grievances were set aside to discuss issues of the economic bent as an increasing sign of the growing maturity of the region economically and move towards greater regional cooperation. (Fackler 2008)

Similarly to the way the EU has developed and struggled with regional cooperation in the latter half of the 20th century, the 2008 summit is indicative of the seeds of greater regional cooperation that is now taking place in East Asia. The most developed economies of the region are starting to take the lead and providing guidance with the emerging China taking a pivotal role. If the EU experience is any indication, the emergence of ASEAN+3 is widely anticipated as greater regional integration helps less developed economies such as the Philippines. Regionalism, rather than the China syndrome seems to be the sentiment of the new emergent world economic order in Asia.

6.12 Family Values

The last section of this chapter looks at the importance of family values of the business groups that dominate the Philippine economic environment. Behind each business group is a business family. Behind each business family is a set of family values. Each family has its own distinct or set of values that permeates through the ownership philosophy of a company, and is inadvertently reflected on the culture of the organisation.

This section emphatically shows why this chapter is supportive of hypothesis 2 but not hypothesis 3 primarily due to the existing cultural norms and business environment in the country. Below again are hypotheses 2 and 3 that were tested:

H2: Post-1997 corporate governance practices in the Philippines institutions and firms will not diverge from indigenous customs.

H3: Philippine firms that have adopted Anglo-American corporate governance practices are more likely to exhibit well-defined principal-agent relationships.

Even if companies have adopted Western-style corporate governance, the form of ownership that is prevalent in the country makes hypothesis 3 difficult to support. One interviewee pointed out that it is not a matter of being “right” but having the “right fit” for the country; therefore agency theory is not applicable in the country:

“The nature of family corporations here, to what extent is it cultural to have family corporations practice? US theory tend to look down on family corporations. The tendency is to assume that family corporations or family controlled firms are necessarily inferior to other forms overlooks the evolution of corporate forms and management practice that they’re superior to.” – academic 1

The Philippines' strong familial culture is reflected in the dominance of family-owned business groups. The family's influence is embedded in the national fabric. Family values cannot be underemphasised in the country:

“It's the family. It's unique compared to the US-UK structures – the importance of family. They carry heavier, louder voice. People listen to them. Not because it's more correct, it's because they have a bigger say, a bigger stake.” – academic 2

The values that drive family corporations were strongly articulated during my interview with the Ayala Group.

“Ayala has 5 core values embedded in the work place:

1. integrity and privacy of the person (honesty in the workplace)
2. dignity of work
3. pride in excellence
4. social awareness
5. commitment to development

“These core values make practising good corporate governance easier as we have developed a culture of accountability and integrity in the corporation. In addition, the champions in the organisations [practise this]. The champion as the CEO and Chairman, this kind of culture filters down, and makes it a natural way of practising good corporate governance.

“Ayala has been in existence for the last 175 years. We are the oldest conglomerate in the Philippines. Even before corporate governance was a byword in the business community, we had long practised good corporate governance.

“Recognise that most businesses in the Philippines are family-owned as well as in most of Asia. Family culture influences doing business in the Philippines. In AC, family culture instils the core value of honesty, integrity, to national economic development, continue to sustain AC. Without commitment to core values, you won't see what Ayala is today.” – Ayala

A business family's values come to the fore in periods of crises. In late 2007, an incident occurred at the Glorietta Mall owned by the Ayala Group. 11 people were killed and injured over 100 people. The force of the blast was such that initial reports suggested a

terrorist or other attack.⁶¹ The mall was one I often visited whilst in Makati. Disaster risk management is a pertinent issue for businesses operating in the country. Even when there was some query over the cause of the blast, In keeping with the perception and wider corporate social responsibility of the Ayala Group, the company compensated those affected:

“We at Ayala Land (ALI) are deeply saddened by what has happened. We, too, are victims of this incident. We will cooperate with the investigating authorities to determine the cause and nature of the explosion. In solidarity with the victims and their families, we are extending moral and financial help, and providing them maximum care and assistance. ALI provided medical attention for the injured, bereavement assistance to families of casualties, and offered counselling services to those affected by the incident.” – Ayala Now (2007)

“The bombing or rather explosion here did not have any longer term impact. The explosion was not a bomb but rather a build up of chemicals. This has been attested by foreign experts who were brought in from various countries. Of course, all has gone quiet as people who are affected in the explosion have been appeased – Ayala has provided those impacted with significant benefits privately (e.g. house & lot).” – private sector (2)

Family values are the foundations of the corporate culture and they strongly influence attitudes towards corporate governance in a business group.

6.12.1 Sentimental Value in Family Ownership

A sentimental relationship is fostered in the family ownership of a business. The

⁶¹ The low level of trust in the state saw disputes between the company and the authorities over the cause of the blast on whether it was a bomb or a methane gas explosion. Conspiracy theories abounded. If it were a terrorist or external attack, it was a violent message sent to silence criticism. If not, it was an internal problem requiring an internal solution. Several inquiries proceeded including a company investigation which conflicted with the official findings. In the end compensation was received from the company, not the state. Perhaps this issue will never be resolved. The complex and sometimes complicated environment of the Philippines is such that the true cause of the incident will probably be never uncovered. However, the incident highlights the hazards of doing business in a country where 20 years after the fall of the Marcos dictatorship, formal institutions aren't or cannot be trusted, and the state is still under suspicion of causing harm to its own citizens. For newspaper articles on the bomb/explosion which ripped through several levels of the shopping centre see the following: Samonte et al (2007), Carvajal et al (2007) and Yap (2007). Two years after the blast, there was still some debate on its cause. See the following: Lopez (2009) and Bordadora (2009)

sentimental value in owning a business founded by a parent or ancestor may define the relationship a business family member has with the business, especially if the member takes an active rather than a passive role. Heroic stories of the founder/entrepreneur generation and the survival of the business provide a basis upon which business family members across several generations can unite around and have a profound sense of belonging.

In the Philippines, some families have managed their business/es through several wars and periods of political instability. Stories of business families under the Marcos dictatorship are strong organisational/cultural artefacts. These stories have become part of family history, folklore and in turn become part of the organisation's fabric.

Out of all my interviewees, one of the strongest sentimental ownership of a family business was exemplified with one particular listed company, a university. A listed higher educational institution is not common in developed countries⁶² however the country's dismal public education sector has seen a strong private sector presence in education. The Philippine tertiary sector is unique in this respect that there is a market value attached to a couple of higher education institutions that have listed on the PSE.

The association between the family and its ownership of the university is high. Far Eastern University (FEU) was founded by an academician, Nicanor Reyes, whose wife was from Santa Maria, Bulacan. They were both killed at the closing stages of World War Two as the retreating Japanese army murdered civilian occupants inside their homes as part of that army's scorched earth policy. The university's president is the daughter the founders and so a great deal of sentimental value is attached to the ownership of the university. The university is strongly identified with the family and she identifies with the institution as her father's legacy⁶³:

"40% of the company is owned by the family. The father of this dominant family was the founder. The loyalty of the Chair – who is the daughter of the father – is unquestionable. She would not be looking at the financial return on investment. To her, this is her father's mission. She considers FEU as taking care of her father." - FEU

⁶² Apart from the Philippines, I am not aware of any other country that has universities that are publicly listed on a stock exchange. I gladly welcome corrections in this regard.

⁶³ A personal account of the wartime experience in Manila during the Japanese retreat can be found in Montinola (1996)

FEU listed due to reasons of tax and transparency:

"The reason for listing on the PSE is to be more transparent. Listing on the PSE requires us to deal with lots of reports. There are also benefits for the stockholders so that they can trade their shares freely. If it was unlisted, the shares would have to go through a capital gains procedure and hence the tax issues are different if you want to transfer ownership. When we listed in 1986, the corporation did not offer to the public first. There was no IPO. The holders of the shares started trading hence they became publicly available. Stock dividends have been declared since then." - FEU

Delicately balancing its role between a tertiary institution and a publicly listed corporation is no easy task:

"To balance our role: our management of the school is divided (between academia and administration). Our academics would hold certain standards [and expectations] of education for our students. Then there is the administrative side of finances and facilities. For as long as people handle this responsibility, all concerns will be addressed. This university has gone through thick and thin. We are doing very well in the academic field as well as the financial – our shareholders are happy, our employees, and our students are happy." - FEU

Generally, shareholders would ensure steady returns on investment and this is one of the enduring debates in corporate governance - the rights of all shareholders to be treated equally. Fortunately in FEU's case, the shareholders are "not the normal, speculative" type. They are not shareholders merely for the sake of financial returns but actually have a stake in the company for more sentimental reasons. The shareholder membership is atypical of a listed company:

"Our shareholders are not traditional investors who'd buy and sell. They are not speculators. Many are holding onto the shares for sentimental aspects. Most of those shares come from parents who taught here and who have been connected with FEU. The holdings are held closely. Many of our shareholders are also our own faculty members. The faculty enjoys scholarships for their children, but not the shareholders. No shareholder has asked for a discount on tuition fees." – FEU

This sentiment was echoed by another company where there was minority shareholder loyalty shown by employees

“Usually the shareholders here are former employees. [The company] used to be diverse with many subsidiaries. Most shareholders here are former employees e.g. power companies, mining, employees of former companies. A lot of them are quite old so that shares would pass on their kids. We see a lot of transfer of shares from fathers to sons.” – private sector

The uniqueness of this listed company is reflected in the stable movement of the FEU share price in 2007:

“There is something unique about FEU shares, the price of the shares don’t go down as would in others. The FEU shares are the only ones that have gone up. We have a 100 par value with an 800-900 market value. It went up gradually. 20 years ago it was at 300, gradually it went up and reached 1200. It has gone down. It was at 1200 because of our declaration of 100% stock dividends.” - FEU

Thus, in this particular case, the orientation is less that of shareholder value, but an emphasis on the educational and long-term stewardship vision for the institution. A share ownership is a stake into the university. Reporting therefore takes two forms: the company’s annual report as required from a listed company, and in parallel, the president’s report which charts the activities of the institution:

“For us the number one emphasis is to educate well ...Even when you advise the public what FEU has to do [with regard to] the financials, the profits are of less priority. There is an emphasis to the top-notchers such as your deans, your officers in the other academic sector and this is not really emphasised in our financial results. The president’s report is also issued at the AGM as this report is the university’s scholastic record of achievements of the past year.” – FEU

For FEU, the culture of the company-university is heavily familial with undertones of loyalty and obligation:

“In FEU, we are used to consider ourselves as one big family. Some employees would say they graduated from here, studied here, I met my husband here, I can never repay what FEU has given me.” – FEU

In the Philippines, behind each company name is a family - the listed company is the public face of the family. The performance of the company is personal - the reflection of its performance on the stock exchange in some way is a reflection of the family's. This personalisation of the company embodies the relationship-based culture of the Philippines.

6.12.2 Succession Planning

When it comes to succession planning, the tangible set of family values guides the process of transferring control from one generation to the next is achieved. Like many other issues in family-owned business groups, support from the controlling owner is needed for succession planning to progress. For most business groups I interviewed, succession planning is in place:

“For family companies, succession is an issue. Some families have adapted better than others. When the patriarch dies, how do you preserve the company? Some have done better than others. For example, the big names in the 1970s are no longer around.” – private sector 1

“The family-owned corporations have done well. Many have done well. The SM group has done well. Those are exceptions. [Some] families are successful in the transitioning to next generation and this is due to the enlightenment of people at the top for a more smooth transition for governance.” – private sector 2

“The [family] has provided for succession...There is a sophisticated estate planning in place” – private sector 3

Only one interviewee was affronted when asked about succession plans for the business, which unusually, was not owned by a dominant family. For one consultant that provides succession planning advice for big business families, discussing succession requires a set of diplomatic skills and the passage of time to keep all parties on side⁶⁴:

“Succession planning is a big issue for family companies. The key to succession planning is to introduce good corporate governance practice when times and

⁶⁴ Chapter 7 briefly mentions succession in SMEs. Succession is an issue that unites most business families whether big or small.

relationships are good between family members. We develop corporate governance improvement programs.

“In the family corporation, it is important not to oversell the source of an idea as this might create tension with another member. Say a brother has a good idea, the other brother might resent that and the tension resulting from the idea is not good. Before introducing the programs, I have to be introduced to the brothers, sisters and other family members to get their trust.

“With real reforms, you have to introduce it diplomatically. It is important that there is a great deal of trust first especially amongst Filipino-Chinese families. Introducing reforms take time as you have to talk to different members of the family. It takes time. On corporate governance, family corporations can talk about succession planning and how to attract human capital.” – ICD

Another interviewee echoed this view of the challenge facing Filipino-Chinese families in succession planning:

“Succession is always an issue in family companies. The Sy Family has 5, 6 siblings in the business. People have begun asking, who’ll run the empire when the patriarch dies? Do you appoint someone to be the new CEO or carve it up to different interests? For example one sibling has one subsidiary and so forth. The Chinese traditionally see the company as their family business. The family is involved in the business. Very few [family members] do something else [besides the family business].” – stockbroker interviewee

Most Filipino-Chinese business families are transitioning from the first to the second generation. Whether successful succession practices will follow the theoretical perspectives above, only time will tell. It should also be noted the Philippines has inherited the Spanish Civil Code provision on joint heirship and this impacts the succession plans of business families and the transfer of wealth:

“There’s inequality in the Philippine civil code with its law of the civil relationships. There’s a whole book on inheritance and succession with compulsory heirship in succession. It is used by the offspring to be able to inherit from their parents. Compulsory heirship freezes wealth and puts the owner of

wealth to tie it up where he can't transition where he would want [to such as in making investment decisions].

“In the Philippines we have the Spanish Civil Code provision and the Roman law of heirship operates here. You've a son that doesn't do anything but profit from his dad. You protect the dad against the banks, against corporate governance, against independent directors. Everything he can do to ensure that the fortune of his dad will be his. There is no fluidity, no movement of capital because it's down from day one.” –regulator

Continental European business families share similar issues regarding inheritance (see Economist 2009c). In the wider context of the current structure of the Philippine economy, this paralyses wealth creation and generation.

6.12.3 Generational Issues

One of the advantages in researching business families in the Philippines is in the variety of experience they offer and the stage of development they are in. For new enterprises, succession is a pressing issue. For the old, established enterprises, succession has been experienced and other issues await them. They are commonly referred to as generational transfer issues or how to ensure the business continues beyond the first, second or even third generation.

Several interviewees pointed out that the second and succeeding generations will not have the same passion or feeling for the business. An entrepreneur who rose from poverty to build a great business will need to pass on this drive to his/her children in a different manner:

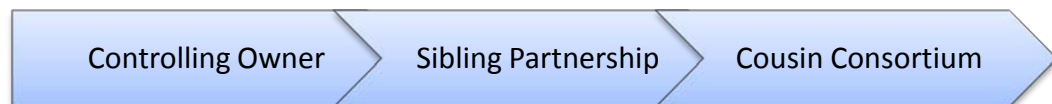
“The challenge is generational - between the builders (imaginative, risk takes, softer on administration) vs. the next generation. The next generation are more risk averse, fundamentally less hungry. You cannot artificially create hunger.” – investment banker

The protection principle comes into play once a business moves to the second generation – how to ensure the wealth built by the first generation is not dissipated by the time it reaches the third generation. Luckily for business families, history is full of the rise and fall of such dynasties:

“The old families, the Rockefellers, the Mellons etc. In Europe even in investment banking such as the Rothschilds, the families see professionals to look at managing the transition. In Asia and the Philippines, there are the Zobels and the Lopezes are beginning to look at that, then the Gokongweis. For families, the next generation has the protection principle mindset to grow the business. [They] begin to adopt management practices to conserve, protect [the business and the wealth]. The family has a unique advantage. [They have a] visionary driving it. [They are] less susceptible to quarter to quarter pressures.” – investment banker

The following figure shows the concept of a business family in three generations:

Figure 34: Family Ownership in Three Generations (Gersick et al 1997: 19)



In the first generation, the controlling owner is the founder/entrepreneur with his/her children. This generation builds the business. When the company is inherited by the second generation, siblings must elect an heir to represent them or they need to cooperate with each other to manage the business. For one company that was set up by a group of siblings, the protection-principle has set in and the second generation of his family are not the risk-takers:

“The company name is down to the names of the two older brothers because we couldn’t decide on the name of the company so we finally came up with that as our choice. We don’t plan to change the [company name] to something that would reflect all the siblings as there is now a lot of goodwill [in the brand] in the export market. The second generation work in some parts of the group. One is Australian-educated. They are being conservative, quieter.” – family member

While for the third and succeeding generations, how to manage a complex structure of cousins who are co-owners but who would not have shared the intimacy of growing up in the same household is the most complicated generational challenge out of all three. How does a business family deal with company issues when membership goes beyond the immediate family to the extended family of in-laws and cousins?

“The challenge is to effectively manage the dynamics of a family-owned business, i.e., having to deal with family members who are involved with the business, having to balance the interests of non-working and working family members, and keeping the unity of the family through succeeding generations.” – private sector 1

“After several generations the business remains a partnership. I am trying to convince the cousin consortium to convert the partnership into a corporation.” – private sector 2

For some business families, more formal mechanisms such as Family Councils have been established to manage conflict. (See Chapter 7, section on Family Councils.) For some business families that endure to several generations, emotional separation from the company is likely to occur as pressures to professionalise require a greater definition of boundaries between family issues and business related issues:

“We have family businesses that have evolved to family run where distinct family issues are kept away from the family business. The Cadbury family started as thus and evolved that way.” –private sector 3

However, not all business families can grow and expand upon their legacy. Some are at the other end of the organisational life cycle of maturity or decline. The following box contains such a story.

Text Box 6: A Portrait of a Business Group in Decline

“Thomas Buddenbrook did not contemplate the future of little Johann with the weary dejection which was now his settled mood when he thought about his own life and his own end. The family feeling which led him to cherish the past history of his house extended itself even more strongly into its future...He said to himself that, however hopeless and thwarted he himself felt, he was still, wherever his son was concerned, capable of inexhaustible streams of energy, endurance, achievement, success - yes, that at this one spot his chilled and artificial life could still be warmed into a genuine and glowing warmth of hopes and fears and affections.” From Thomas Mann’s *Buddenbrooks* (1999: 499)

Most business groups I interviewed were and are highly successful. They were implementing corporate governance as part and parcel of doing business in the modern age. They gave their time freely to me and had no compunction with implementing corporate governance in their organisation because for the most part, they were the leading industrial lights of the Philippine economy: successful, expanding, growing, entrepreneurial.

However, as to each rule there is always an exception. This case study is a portrait of one exceptional corporation. Exceptional in that it was not like the others. It was a family corporation in decline. The following is a narrative of my thoughts after I had interviewed this company. The usual adages apply: the profligacy and the squander of the third generation; the life cycle of a company; and how for everything and every company there is a season, in this case the time of decline...

Interview Observations:

Families rise and fall. This one is in decline. You can sense it as you enter the building. The corporation used to be powerful and strong with a prominent family behind it. The present company must be the outcome of what happens when clans fight over the soul of a business. It is akin to living the later chapters of Thomas Mann's *Buddenbrooks*.

I am privileged to access this corporation. Unlike the others, it is not in active competition to sustain its position. It is in quiet decline, or perhaps a steadfast position after divesting itself of its other arms and financial responsibilities.

The family, in the words of the Chairman, want to be passive. They want the peace after the long, weary war. The corporation is past its glory heights, but it is still an on-going concern. It is now in the hands of the third generation. There is a fourth generation in the wings, perhaps not waiting as eagerly - or dreading - as they wait for time to render them the responsibilities of a family corporation. I ask who is in the fourth generation and the response is a twenty-something who is enjoying the freedom of youth.

Perhaps after the battles over the corporation, it is time to savour the fruits of the profit of the previous generations. This is what they mean about quiet enjoyment.

The office of my interviewee is in an open plan floor. There is a sea of cubicles but no guarantee of privacy. He is young but already hunchbacked, a decade added on his youthful face. He is studious with a maturity beyond his years. Perhaps they saw that when they hired him.

There is an underlying current feeling that this is the post-bellum corporation. The whole floor looks like a medium-sized office of a not so busy accounting firm. There is no hurried efficiency that I see in other corporations. There are no young assistants with make-up or hairstyles rivalling Marie Antoinette's. My interviewee constantly refers to the loyal, older, female employees who bear witness to the trials and tribulations of the company's life. He says they have been there all the time. They must have seen the heights and downfalls, the tensions, and now the quiet enjoyment after the turbulence.

This is what research truly is, it allows you to access corporations like these – insight into slivers of corporate life.

My interviewee and I also spend some time discussing his tribulations with a London fund manager who was very demanding over the phone. I tried to explain to him how powerful institutional investors are in Anglo-American countries. He said he couldn't even understand his accent at times. His superiors kept passing the demanding London manager to him. He says that over email he had been pissed off with his demands but over the phone the Londoner sounded all professional. I told him, it must have been 3am

in London to have rung them in Manila during office hours. That was, at least, considerate of the Londoner, but my interviewee seemed pre-occupied about the requirements of the institutional investor.

He says he's not even a major shareholder, a minority shareholder who presumably must be managing various accumulative funds. I told him the London manager probably needs a big enough shareholding to warrant the company's attention. The hazards of doing business in a developing market. It's how big you are, not who you are. Not all shareholders are treated equally. My interviewee doesn't seem to care about it. He just wants the Londoner's demands to be over and done with. As a shareholder, he'll probably want to demand more. He mentions "pagkikisama" – the cultural concept of getting along with each other. The Londoner doesn't know it. It's a cultural clash. When a Western foreign investor clashes with a Filipino company. The manager probably looked at the company list of the PSE and thought the company a worthwhile investment. Perhaps the listing on the PSE is a reminder of its previous existence when it actively moved the market. Its legacy as a major corporate player. Now, the ticker symbol is a reminder of history and how things once were.

It is in these moments that one appreciates research and the wealth of data produced. These insights of human interaction are revealed on this level. These little anecdotes, these little pieces of corporate life. My interviewee sees me smile. He asks, are my responses so very different from the others? I say to him that I am looking for a variety of responses. He doesn't know that he's made my research so very worthwhile.

He says this is the second interview he's done on corporate governance and considers himself able to respond. I don't ask him what the previous interviewer's questions were but I can gather from his responses – disclosure seems to be the same, but on my other questions about culture, about opinions...they are different. He says my questions are broad. I've never heard another respondent say that. I reply these questions are broad so my respondents have the leeway and the flexibility in their response.

This research is not just about the biggest corporations, it's also about the others like this one. What happened? Is it about competition, is it about ego? Like life, it's the variety of experiences that make it possible to explore and wonder about the human existence.

I started the interview thinking this will be the usual responses. It wasn't. With the realisation this entity was echoing that Hanseatic trading company at the closing stages of the 19th century made me more appreciative of Thomas Mann's writing. For Mann, to write about the rise and fall of his family and his family's company must have been achingly personal. For me, I'm just a mere observer. I'll collect this data, analyse it with others and perhaps realise how unique this interview has been.

He starts the interview by looking at my print out of the company's PSE listing. He immediately seizes the printout and corrects some of the information. Throughout the interview he scrutinises what I write. 15 minutes into it, he realises how different this must be so he asks for anonymity. I ask him if there is a book on the family. There isn't one.

In the foreseeable future, business groups will continue to dominate the private sector landscape of the country and corporate governance in the Philippines will be applied, altered, supported (or not) and shaped by the owners of these groups.

CHAPTER 7: THE BOARD AND MANAGEMENT – CONTROLLERS OF THE COMPANY

This chapter looks at the internal governance aspects of the company, in particular the role of the board and management as controllers and directors of the company.

In the Philippines, the managerial agency problem as found in Western, listed, non-family-owned companies do not exist. Western agency problems do not exist in the country because the managers are the owners. However there are family-agency problems where the executives act wholly for the interests of the family at the expense of others including that of minority shareholders (see Chapter 6). However, this can be mitigated when the family-owned company is run professionally. Furthermore, the influence of the family is bounded by professional managers. The introduction of independent directors to Philippine corporate boards is another important reform to limit the family's self-interests in the business.

Philippine corporate governance is bounded by the cultural norms and values of the country. While Western corporate governance reforms have had an impact in formalising the conduct of Filipino companies, corporate governance is implemented in a manner that reflects the visions and values of its family owners. This chapter is divided into the following sections:

- The different roles and various structures of the typical Philippine company board are discussed: the CEO, the Chair, duality and separation of both roles. These two roles are normally filled with representatives from the major (family) shareholders and are the ultimate expression of their control of the company.
- The introduction of the independent director on Philippine boards. As the seismic corporate governance reform, this outsider function has had a profound effect on the insider culture of Philippine corporations. Firstly, how the independent director is viewed and defined. Secondly, the pool, reputational value and 'independence' of directors are also explored. Finally, how independent directors are perceived as a threat to the business and its future are discussed.
- In contrast, executive directors who in most cases are also members of the owning family are faced with their own issues as owner-manager and pressure to professionalise. Some companies have successfully introduced outside

professional managers while others are transitioning towards this.

Professionalisation is a major concern at the SME end of the business spectrum and director training and education are discussed in the smaller family businesses.

- Board committees are structured by the board to oversee its management. The most cited committees amongst interviewees are discussed: audit, risk, nomination and executive. The conduct and culture of Filipino board meetings is also explored. Filipino boards manage conflict that reflect the national culture which values non-confrontation and consensus decision-making,
- Finally, the last, albeit no less significant section, discusses other decision-making bodies that have an impact on the company board and management: the family council, family board and advisory board.

Similar to Chapter 6, hypothesis 2 is supported while hypothesis 3 is not supported in this chapter:

H2: *Post-1997 corporate governance practices in the Philippines institutions and firms will not diverge from indigenous customs.*

H3: *Philippine firms that have adopted Anglo-American corporate governance practices are more likely to exhibit well-defined principal-agent relationships.*

The reasons are familiar. Management is under the guidance and control of ownership interests. The independent directors' section of this chapter exposes the tensions that occur in trying to bring well-defined principal-agent relationships in the country.

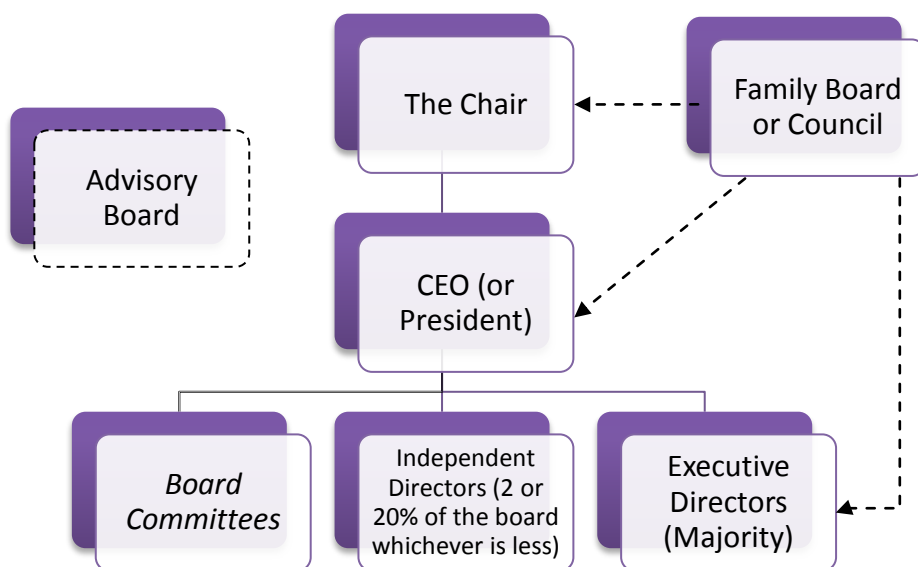
7.1 Board Structure

All Philippine companies I interviewed follow the unitary board model. There is the Chair (who is normally the patriarch, founder-entrepreneur or family member representative) and the CEO/President (who may or may not combine this role with that of the Chair). The rest of the board is comprised of executive directors, who comprise the majority of the board, who sit on various board committees. The 2002 reforms have a mandated requirement that 20% of the board is comprised of outside, independent directors or two independent directors whichever is less (SEC Corporate Governance Code 2002).⁶⁵The SEC Code also advises board membership ought to range from five to

⁶⁵ "II The Board Governance

fifteen members. The figure below is a simple model of a typical Filipino listed company board:

Figure 35: Structure of a Typical Philippine Company Board



While the Philippines may not follow the two-tier board model as in Germany, there are other fora where the controlling family’s power is expressed and whereby they exercise their authority as owners. These forums include supplementary board-like structures such as the family council; family board and an advisory board. The next sections discuss members of a Filipino listed company board: CEO, Chair, Independent Directors, Executive Directors and Foreign Directors

7.2 CEO

The Chief Executive Officer (or CEO) holds the most powerful leadership position in the company. The CEO leads, champions, and sets out the culture and direction of the

1. Composition of the Board

The Board shall be composed of at least five (5) but not more than fifteen (15) members elected by shareholders. Public companies shall have at least two (2) independent directors or such independent directors shall constitute at least twenty percent (20%) of the members of such Board, whichever is the lesser. All other companies are encouraged to have independent directors as well.

“The Board may include a balance of executive and non-executive directors (including independent non-executives), having a clear division of responsibilities such that no individual or small group of individuals can dominate the Board’s decision making.

“The non-executive directors should be of sufficient qualifications, stature and number to carry significant weight in the Board’s decisions. Non-executive directors considered by the Board to be independent shall be identified in the annual report.” SEC Code of Corporate Governance (2002)

company. According to Landbank CEO, Gilda E. Pico, her "idea of an effective CEO is one who empowers and inspires his/her people to contribute to the attainment of the organisation's goals. One who has a clear grasp of where he/she wants to see the organisation down the road and knows what and how to execute strategies to make this vision a reality. Effective CEOs are also those who have the ability to make crucial decisions even with limited information on hand." (Reyez 2007: C1)

In some Philippine companies the title of President is interchangeable with that of the CEO. The use of President to refer to the most important person in the company is influenced by American business culture that spread to its former colony. The President of the company "mirrors the [American] President's position as Head of State and Commander-in-Chief." (Cadbury 2002:114)

The family-oriented, personalistic culture of the Philippines also renders the CEO as the paternalistic figurehead commanding loyalty that can border on the unprofessionalism. As pointed out by Dr. Ricardo Lim from Makati's Asian Institute of Management, the perception of CEOs in the Philippines is dissimilar from the emotionally distant CEOs of Western corporations. The CEO is seen as the father or mother of the company and CEOs in the Philippines need to navigate through this perception:

"Asian corporations are more paternal or maternal, but there is a very thin line between fraternalism and professionalism. They don't mix well. When a CEO becomes a cult-like figure...where employees put their lives in his hand, not make any decision because he is 'dad', and follow him through the depths of hell, if necessary, then there's something wrong...CEOs need not be stern. They can actually be personally pleasing and quite reasonable to be with...They can sympathise [with you] if there's sickness in the family; any human can feel that. But to be very 'chummy' or friendly with your employees is dangerous." Accordingly, forging a close relationship with an employee might affect a superior's ability to discipline him: "There might be a feeling of familial betrayal because the relationship is already too personal. So there has to be a distance." (Bobadilla 2007)

In first generation companies, the CEO is usually the founder/entrepreneur. In second or third and succeeding generations, the CEO position is usually held by a member of the controlling family and not by an outsider.

7.3 The Chair

Equally as powerful, if not more influential, in a Philippine company is the Chairman. Where the CEO controls the company, the chair controls the board. Some companies have the role of chair and CEO combined (see next section), in which case the chair is seen as the ultimate leader of the company. The chair is the voice of authority on the board and sets out the culture of the board.

“As chairman of the company and as mentor, and as manager of the listed company we manage in the Western business practice and we have done so for years. Since I have become Chairman, I have insisted that we run in a particular manner. Hopefully we are doing the right thing: profits, checks and balances and the audit practice distilled by the directors.” – Chair

Where the chair has an executive stance, the decision-making process becomes unilateral:

“It’s part of the culture [here] where the chair is normally occupied by the patriarch, then by the children. It is an omnipotent founder-chair with the children as part of the governance management team. Culturally, because of that structure, it’s difficult to discuss on a strategy and policy level when there is a strong father sitting as chair and dictating to the board. The Philippines is not known as confrontational. [The board] won’t exhibit open discussion and the loss of face is also important. There is a one-way traffic [in decision making] with the patriarch...One of the top five banks [here], can’t accept criticisms. They can’t stand people who say the emperor has no clothes.” – private sector 1

Similarly, as the chair is usually the biggest shareholder or family member representative, what the chair envisions for the company will be the direction the company takes:

“It’s family-owned, so whatever is the vision of the Chairman, then that is the [direction] we’re going to take...We keep a pretty low profile, not much happening, no drama, stable composition. Previously it would have been full of drama but now the Chairman doesn’t want that anymore hence we want passive investments.” – private sector 2

“For the President, he is on day to day activities, implement activities and implement ideas that the Chairman thinks brilliant. Many ideas also come from the other officers. [This is] the decision making process in action; The Chairman has an idea; Management will study the idea: - the President decides on whether it should go ahead. He communicates the idea to his VP, Treasury, Marketing, Study Group etc. The study group reports – the board decides whether to go ahead on the basis of the results.”-private sector 3

A different reasoning on why the authority of the chair is so omnipotent and concentrated was proffered by a regulator. He suggested the legal liabilities associated with signing off certain documents promote this autocratic oversight:

“The biggest shareholder is the patriarch-founder that is usually attached to [the company]. When the banks lend to the corporations, the banks require them to sign with liability. This man needs to sign with the company secretary, with the corporate officer. That in a sense breeds a control aspect from the family to put its foot down on corporate governance. Several families here put their foot down. It’s a bad situation – they don’t want to let go of control. The patriarch being made to sign off the loan [that is] continuously rolled over - the father’s fortune to fall into a situation where it can be foreclosed.” –regulator

The enormity and awareness of one’s responsibilities as chair was echoed with one interviewee:

“At the end of the day, the annual report has my signature on the bottom.” –
Chair

The following passage describes how the Philippine board culture operates due to the influence of the chair:

“The chair isn’t like the rest. This is cultural thing that you can’t have a board of trustees of one person, one vote environment. It’s not one person, one vote. What’s your decision? Four board members saying yes, three people saying no? It doesn’t happen.

“Many times it goes this way: seven people talk, they get together, [there is] consensus building. Usually, all seven say yes. The Chairman has a louder voice,

[a] more convincing power than most. He can speak softly, people will listen. This is the cultural consensus building.

“The Chairman selects the independent/executive directors. The board of trustees creates the nominations committee. They choose the nominations committee. [The] same goes with the remuneration committee. The board of trustees selects people who’ll decide the remuneration. The board of trustees selects the committee who’d select independent directors. [For] independent board members – who decides to puts you on the board? It is the Chair.

“The consensus building is due to the voice of the Chair. It is definitely not proportional to what it should be. It’s not one vote, one person. But it’s not the environment here. Does the board say ‘Let’s vote’? No, almost [always] there is never [not unanimous] voting on the board. If a board member is not convinced [by an issue or decision], the tendency is they convince one other [before voting takes place].” –academic

This view on how voting takes place on the board level was echoed by another:

“The compliance officer simply fills out a form that everything has been completed [to fulfil this as part of] substantial compliance. [The board members are] independent but not independent. The Chairman tells them how to vote. It is the omnipotence of the chairman - over 50% of Philippine business is dominated by family corporations. Who can really be an independent [director] asks [Washington] Sycip on boards. Sycip can speak independently but he is part of the very few people who can.” –private sector 4

Precisely because of the overwhelming authority of the Chair that this issue has become one of the main corporate governance problems in Philippine corporations:

“The corporate governance dilemma facing the Philippines and East Asia is the omnipotence of a chairman vs. the board. This is in contrast to the Western corporate governance dilemma of trying to discipline the omnipotence of managers vs. the board” – CG workshop

Consensus-building is the distinguishing feature of Philippine boards and this is due to the dominant chair. It is unheard of to have dissenting voices or even voting by board

members on an issue. Conflicts are rare, mediated or informal. Formally, there is no such thing as a split board, if there is, members have to be convinced or swayed to support an argument. Far from *primus inter pares*, the chair is *über alles*.

7.3.1 CEO Duality or Chairman-CEO Combination

The roles of Chair and CEO are the most important and powerful in the company. When they are combined, it is the ultimate expression of concentrated power and absolute control by the majority owner or owning family.

In the 2002 SEC Code of Corporate Governance, there is no mandated preference over the combination or separation of the CEO and Chair position in the company. However, when the role is combined, the Code requests that proper supervision be exercised by the board:

“Where both positions of the Chairman and CEO are unified, there is clearly one leader to provide a single vision and mission. In this instance, checks and balances should be clearly provided to help ensure that independent, outside views, perspectives, and judgments are given proper hearing in the Board.” (SEC Code 2002)

In reality, monitoring a CEO-Chair can be an unsurmountable challenge. The CEO-Chairman duality is a feature of Philippine corporate governance and is common in companies as the business is seen as an extension of the family. In companies that I interviewed that had CEO duality the main reason for the combination was the overwhelming wish by the majority owners (usually a family) of the corporate entity to have this in place:

“The combination has always been like that. The CEO, Chairman, President, Management. The family practically owns the company. Because we’re a holding company, we don’t operate much. Our investment is in passive investments, bonds, hedge funds. There’s not much need to separate the Chairman, CEO. Even if it gets separated between the brothers, it will still be under the same family.” – private sector 1

“I consult with the board. This combination of Chairman and CEO – I don’t know. There are pros and cons. In the US it is the trend (of separating the roles).

When we list it's possible [for the separation to occur]. I do think there are advantages of separating the board and the management. But that will be applicable in large corporations with no real controlling shareholder. I own almost half of the company so [this issue] doesn't really matter." – CEO-Chair

"In the Philippines, it is common for the chairman to be chief executive officer as well. This is because the board which sets policy and directions for the company normally wants its chairman to have management responsibility to better oversee the activities of the corporation and have control over its progress. The day-to-day management is delegated to a chief operating officer⁶⁶ with the rank of president and this is the case in Benpres." –private sector 2

The following comment from a holding company interviewee begs the question whether separating the two roles is a matter of image – if investors see the separation, does that instil confidence amongst outside investors?

"The separation of Chair and CEO? It's not practical. The family runs the company. There's a family chairman. During the IPO the roles were separated." – private sector 3

For the company in question, after the IPO, the two roles were united again. This brings to mind the important distinction between a company that is simply family-owned and a company that is family-owned AND family-controlled.

The duality seems to be most present in companies where there is a strong family involvement in the business. This was reinforced at a corporate governance workshop I attended which had participants from family-owned medium sized enterprises. Nevertheless, the introduction of the primarily Anglo-American concept of separating the two roles is gaining currency:

"In the Philippines many of the family corporation owners - many of them say - the separation of Chairman and CEO can't be implemented as we are the owners, we're entitled to run the companies themselves. There's also *malasakit* (empathy). But it makes sense later on to separate. The trend is now, we are now

⁶⁶ This statement resonates with the Hambrick and Cannella Jr. study which found that "CEOs are more likely to have COOs when they are also board chairman...CEOs who fulfil these two role sets – as top executive and board chair – may feel the need for assistance from COOs." (2004: 974)

seeing the owners who are in their 60 and 70s being convinced to start professionalising. Just run the board, let succession [happen] or [allow] the professional executive run from the President-down - to let it be run by professionals and appoint the President and CEO.” – CG workshop

The CEO duality is a common structure for most East Asian corporations. The positive side of having an omnipotent chair was highlighted in a workshop discussion at the annual 2009 International Corporate Governance Network conference held in Sydney⁶⁷. A partner with an institutional investor firm Taiyo Pacific Partners⁶⁸ which oversees three Japanese funds comprised of 42 companies, stated that while most boards in Japan were insider boards, dealing with someone who has both combined roles (Chairman and CEO or CEO and President) is akin to dealing with someone who has the power of a North Korean dictator. The positive side to this dictatorship is one need only engage with one person on corporate governance. If the person is supportive of corporate governance, this spreads to the rest of the board as it isn't necessary to convince other board members. Thus, from at least one institutional investor perspective, a combined role can be a positive influence in introducing corporate governance reforms.

7.3.2 Chairman-CEO Separation

In companies that have separated these two positions, the family owners made a conscious decision to have this segregation with the division of labour and responsibility the main motivation, and as effective corporate governance practice:

“When the IPO was done, there were three independent directors on board out of seven including the Chairman. The Chairman and CEO roles are segregated to this day. The CEO of the company is the executive management and part of the significant shareholder group. The Chairman is not involved in the executive management. The board wants to separate the two functions – the CEO is day to day management.” – private sector 1

“The Chairman and CEO roles are separated. This serves as a check and balance, and is effective as a corporate governance policy.” –private sector 2

⁶⁷ <http://www.icgn.org/conferences/2009-sydney/-/page/644/> accessed 15 July 2009

⁶⁸ <http://www.taiyofunds.com/home.aspx> accessed 15 July 2009

“The reasons for the separation are the Chairman wants to be on his own on policy, presiding on the board.” –private sector 3

The separation is normally between two family members usually father and son:

“The Chairman/President is usually the father/son separation. At Ayala it’s two brothers who take each of the chairman roles in their group of companies. The president would be a professional manager.” – private sector 4

“The role of Chairman and President is separated between father and son. My principals are adverse to the label of CEO. The President is like the CEO. He is also the COO which we say stands for the title “Child of the Owner.” –private sector 3

There is the less common separation between a family member for chair and non-family member professional for CEO:

“The Chairman and President [role] is separated. The Chairman [represents the family owners] and has a different set of responsibilities from the President [who focuses on other issues].” –private sector 5

“The CEO of the company is the executive management and part of the significant shareholder group. The chairman is not involved in the executive management. The board wanted to separate the two functions as the CEO is day to day management. There is also the COO which is separate and different.”⁶⁹ – private sector 6

Separating the Chairman and CEO roles take on a heavily significant ceremonial display especially when the company and the family owners are undergoing a succession process:

“There is recognition of the Chairman as the elder person – as one transfers power, [there is a] generational transfer of power. Beyond family corporations,

⁶⁹ This statement suggests reasons of size and performance – as this medium enterprise company grows, so do the operational and professional requirements. In Hambrick & Cannella Jr’s study they focused on the relationship between CEOs and COOs including a contentious finding that “COOs provide CEOs with ready scapegoats if performance problems arise.” (2004: 977). Investigating the different roles of members of TMTs were beyond the scope of this study but this sliver of insight into their functions show that this research field is a fecund ground in exploring the micro level interactions of Philippine corporate boards.

the Chairman is the older person, the guiding spirit. The President has to get things done, there's value to that." –private sector 4

In the case of Petron, an energy company whose major owners in 2007 were two government owned corporations (since altered at the time of writing) – PNOC (Philippine National Oil Company) and AOC (Aramco Overseas Company BV) of Saudi Arabia - the role of CEO is alternated between the two major shareholders. The Chair is executive, and the President is executive. These two positions represent the interests of their shareholders therefore the company does not have an independent chair:

"The role of the Chairman and the President are separate and their individual approval limits are well defined. Beyond their individual approval limits, certain projects will have to be approved jointly by them or brought up to the Board, as the Approvals Manual may require. The CEO role is rotated between the Chairman and the President, once every two years. All these are essentially found as among the more important provisions of the shareholders agreement between PNOC and AOC. The CEO looks after the day-to-day affairs and he is assisted by a Management Committee (Mancom) composed of the Chairman, the President and all the Vice Presidents of the company which Mancom meets weekly." – Petron

Finally, from the perspective of a Chairman who has clearly defined boundaries between himself and executives:

"I try not to be an executive chairman but just a chairman. There's a President and Executive Vice President (EVP) and they'll always come to talk to me. All of our CEOs in the region ring and talk to me on a daily basis several times a day...Some CEOs and directors don't like it when I question things. A couple of directors ask all sorts of questions and I think that's good." – Chair

Separating the role of chair and CEO eases the burden on one person discharging both sets of duties.

7.4 Independent Directors

Out of all the Anglo-American corporate governance reforms introduced into the

Philippines, the introduction of the independent director is the most controversial and has had the most impact in changing the board structure of companies:

“Corporate governance as practiced in other countries has had a measurable impact on Philippine companies. For example, the Securities Regulation Code, (Republic Act No. 8799, which took effect on August 8, 2000) requires certain classes of corporations to have at least two independent directors on their boards. The qualifications and disqualifications of these independent directors are provided by law and by regulations of the SEC. As defined in Section 38 of the Code, an independent director is “a person other than an officer or employee of the corporation, its parents or subsidiaries, or any other individual having a relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

“This has had a profound influence on businesses since, prior to the enactment of the Code, corporate boards were usually staffed by persons heavily involved with the company in a way that conceivably precluded the exercise of independent judgment. With the advent of the Securities Regulation Code, companies are scrambling to comply with the independent director requirement.” – PSE

The implementation of independent directors has caused enormous upheaval in the corporations, especially when they were introduced on listed holding companies which are generally seen as the domain of the owning families. To speak of corporate governance in the country, is to elucidate how companies have tried to adjust to the introduction of the independent directors:

“Initially, it was difficult to implement the rule that directors must adhere to the ‘fit and proper rule.’ The [companies] questioned the legal basis, even if it was not in the Corporation Code. There is a basic corporate code in the 1980s. Chairman Bautista and the SEC took the position to include the ‘fit and proper rule’ in the Manual and Code as the main criteria of independent directors.” – SEC

This section provides the various issues and differing perspectives on the introduction of this particular corporate governance reform that shook up the corporations of the country.

7.4.1 Independent Directors Legally Defined

With most corporations being family-owned and the company seen as the family's personal fiefdom, having a family outsider (or two) sit on the corporate board was, and is, to most companies a source of discomfort. The introduction of the independent director was codified in the 2002 SEC reform:

"SRC Rule 38 – Requirements on Nomination and Election of Independent Directors

7. Number of Independent Directors

A. All companies are encouraged to have independent directors. However, issuers of registered securities and public companies are required to have at least two (2) independent directors or at least twenty percent (20%) of its board size, *whichever is the lesser*. Provided further that said companies may choose to have more independent directors in their boards than as above required.

B. The Exchange/s are required to have at least three (3) independent directors. To effectively carry out the provisions of Section 33.2(g) of the Securities Regulation Code, the Exchange's independent director or a nominee for such director shall not solicit votes for himself."

A debate on this requirement was present during the course of my interviews when there were conflicting accounts over the phrase "*whichever is the lesser*" which appears in the first paragraph of Section 38 (7). One regulator stated this was a typographical error and the requirement was suppose to be more stringent – that is, to have at a minimum 2 directors or 20% of the board to be independent. Thus, for boards that have 15 members, a minimum of 3 independent directors need to be present.

"[If you look at the PSE board] they have introduced professionalisation in the stock market, so there are 20% independents on that board, 2 to 3 independent directors. There was actually a typo there [in the regulation], we meant 20% or at least 2 independent directors – whichever is higher. At the moment it appears it says 'whichever is lower'. But we have this amendment ready for the bill." – SEC 1

Another regulator contradicted this account stating it was meant to be the lesser. In

response to a question on why one conglomerate only had one independent director out of seven directors:

“[This requirement] was drafted in the commission. The 20% limit recognised in family-owned companies with 2 directors on board. One director in a board of five must be really independent. This would be sufficient in the selection whether he is an independent director. [Regarding that company], it would be 1.4 independent director - 20% of 7 directors so you don't have two directors whichever is less. It's not a typo. [However] we hope we'll see the requirement [of at least two].” – SEC 2

The companies being regulated by the SEC were well aware of the original idea to have more independent directors than currently stated. As one pointed out:

“In the provision of the law, there was the 20% requirement but there was an error which even now has not been rectified.” – private sector 1

As with most changes, the corporate response to this legislated requirement depended on the company. For the few companies who had already professional managers educated in Western business schools and instituted Anglo-American corporate governance before the SEC reforms came in to effect, there were few problems in adjusting. Where the company is a large conglomerate, meeting the SEC requirements for independent directors occur on two levels – independent directors on the boards of the operating companies, and independent directors on the holding company or mother company board. The latter is where the interests of the family are exercised more comprehensively and where this reform was greeted most offensively.

For the many companies who hadn't professionalised, whose managers were mainly family members, and who weren't exposed to Western business education or practices, the reaction to the introduction of the independent director was defensive, negative and highly critical.

Appendix 5 contains a table that lists the extensive qualities that qualifies or disqualifies a person as a director on a Philippine company board.

7.4.2 Concept of the Independent Director

The SEC sees the independent director as the intermediary between the public at large and the company. Attendance of independent directors to board meetings is crucial to the way the SEC monitors how this reform is being implemented.

“One of the requirements which we monitor every year amongst companies that we regulate will be 2 certifications:

1. A certification issued by the corporate secretary certifying the attendance of directors during meetings.
2. A certification issued by the compliance officer on the extent of the company’s compliance with its corporate governance manual.” – SEC

The SEC also requires independent directors to submit a certification on their qualifications and disqualifications for the position⁷⁰:

“It is not enough to have disclosures in periodic reports for selected companies. When the SEC feels they require to submit more certification, they do so under oath so they are [reluctant to falsify their qualifications] before they exclude certain allowances. We’ve found inaccuracies [in the qualifications of the independent directors] when double-checking some of the periodic reports.” – SEC

Hence, there is great emphasis on the independent director as key corporate governance reform:

“Why are these certifications important? We’d like to know if indeed the independent directors actually attend the meetings as they state. The independent director is like the equaliser. They don’t always necessarily agree or disagree with most of the board’s view. They give objectivity during the meetings and they can say yes when indeed they [want to] say yes, and no when it’s no. We ensure they are real independent directors and not just independent directors on paper and not attend the board meeting.” – SEC

⁷⁰ A copy of the certification can be found on the following website
<http://www.sec.gov.ph/notices/independed%20directors%20-%20cert%20of%20qualification.pdf>
accessed 18 September 2009

The SEC requirements mean companies must formalise the process in which independent directors are nominated (see Nominations Committee later in this chapter):

“Under the rules of the SEC, the nominees must be stated. In the nominee form, there must be a mark on who is the independent director. Independent directors must submit their resume. Together with a list of nominees, they must include indications to submit [their nomination] to the shareholders’ meeting, then their election as independent directors of the company.” –private sector 1

The best indicator of a company’s practical implementation of independent directors is whether or not these outsiders attend or avoid meetings:

“The best evidence is “my attendance in meetings”. If directors are absent in more than 50% of meetings, there is a temporary disqualification and they have to show why they ought not to be disqualified. So if independent and regular directors are absent for more than 50% of the meeting they are disqualified. When we find that a director has incurred more than 50% absences and they are renominated for direct re-election, then we expect the company to make a justification why they should be re-elected.

“If there are reasons why they could not attend, they must advise. Not only can they say, ‘we can’t drop his name due to him being indispensable to the company or that the corporation/blockholder he represents has a substantial stake in the corporation’ they must give due reason. For example, teleconference meetings are acceptable but the company’s minutes must show that. For the SEC, there was a circular outlining the different requirements of the meeting via teleconferencing. There is reason why a busy director can’t attend. With teleconference they must document the meeting. If you can’t show the documented meeting then there must be adequate representation.

“We get to monitor the attendance of directors. We look into the qualifications and disqualifications. Sometimes, [companies think] we aren’t capable of determining inconsistencies, we receive the information statements. When director election time comes, we compare these with the issuances and the disclosures in the past so that’s when we discover inconsistencies and even the shareholders.” – SEC

Non-attendance by independent directors is considered a significant signal indicating poor practice of corporate governance.

7.4.3 Welcoming Independent Directors

For one company that has incorporated Western business practices, the introduction of the independent director was an easy transition:

“Our independent directors are not a problem. We are used to them. It was not a problem appointing the new independent directors.” – private sector 1

In one company at least, there were more independent directors than the requirement and the performance of their independent directors impressed the managers:

“Under SEC regulations, there must be at least 2 independent directors. We have 4. They are rare individuals. Not only do they meet the mandate but they also do a good job. Our independent directors are like clinicians. They come around twice a week and they keep clinical hours reviewing the company. Most directors have also attended the meetings. Our independent directors have their own companies. They are totally independent and not executives nor officers of the company. [The owner] didn’t want an executive officer and approve something which he had only recommended. The only executive director is his son. All the others are non-executive directors, no management positions.” – private sector 2

One interviewee reflected that they had competent board members prior to the reform and the addition of independent directors has not made much of a difference. However the respondent concedes independent directors proffer a different perspective on the business:

“Before 2003, there were no independent directors. The introduction of them has not had a big impact. The independent directors - while they contribute to good management – do not mean that previous board members were less capable. In a comparison between independent directors now and not being independent [previously] – there has not been much difference. The contribution is much the same [prior to the reforms and after]. Now we have independent directors, they see things and bring different ideas...Some board members are now getting other

opinions. It helps us but it doesn't mean anything's better than previously." – private sector 3

For companies I interviewed, most were positive in their assessment of their independent directors' contribution to existing business practice.

7.4.4 Independent Directors in the Ayala Group

The Ayala Group of Companies is held in wide esteem as being the most professionalised conglomerate in the Philippines. As such, the requirement of having independent directors has been met on the boards of the Ayala group of companies, including the mother company Ayala Corporation (AC):

"To the extent of compliance, all public companies are compliant with the rules of corporate governance promulgated by SEC. In the case of the Bank of the Philippine Islands (BPI), we have three officially declared independent directors out of 11 directors. But we have more than three officially recognised ones. Since there are seven directors in AC, there are three non-executive directors out of seven.

"Ayala Land has three independent directors, one executive director including the Chairman. Other publicly listed Ayala companies have two or three independent directors. There is balance of independent directors and non-executive directors. [There is] greater [emphasis on] the non-executives part on the board of directors." –AC

Where there is a significant outside shareholder interest in an Ayala company, then they are represented on the board:

"There's a Mitsubishi representative on the AC board as Mitsubishi is a significant shareholder and is entitled to own a seat. Mitsubishi owns 10% of AC. The Mitsubishi representative is a non-executive director.

"For Globe, it is an early, young core business. Our interest in old Globe Mackay which used to be a US company; we took control of in 1993. In 1995, Singtel (Singapore Telecom) became a partner. AC considered Globe a limited public utility. The effective ownership of Singtel is between 35-38% and they have voting

rights. There are 2 Singtel directors on board, but we have nominees outside. There are independent directors, an ambassador to the Court of St James, an ex-undersecretary of Finance, Secretary of Finance.” –AC

According to another interviewee, foreign shareholders in Ayala companies have seen corporate governance improved or complemented in those businesses. Indeed, the presence of a foreign investor indicates confidence in the company as outsiders are expected to demand greater transparency and improved disclosure:

“Globe is owned by two major blocks – SingTel and Ayala. There are around 4 independent directors out of 11. On BPI, it’s the Ayala Group and the Singapore Bank. SingTel and Singapore Bank are both eventually owned by Temasek Holding. The partners of the Ayalas are the Singaporeans. They are very transparent, practising high levels of corporate governance.” – private sector 1

The fiduciary duties of Ayala company directors are well-established and have been institutionalised to an extent:

“Based on our corporate law, the board exercises a fiduciary capacity. As stewards of the company, due diligence [is applied] as a good father to the family of companies. AC through time has long been here. No particular shareholder complaint of negligence. All our directors are conscious of that role. Well-advised, well-informed of responsibilities to shareholders and we’re very conscious of this.” –AC

The following figure is Ayala Corporation’s board structure in 2009⁷¹ and family council:

⁷¹ Source: Ayala Corporation (2009) Board of Directors
http://www.ayala.com.ph/about_ayala_leadership.php accessed 19 September 2009

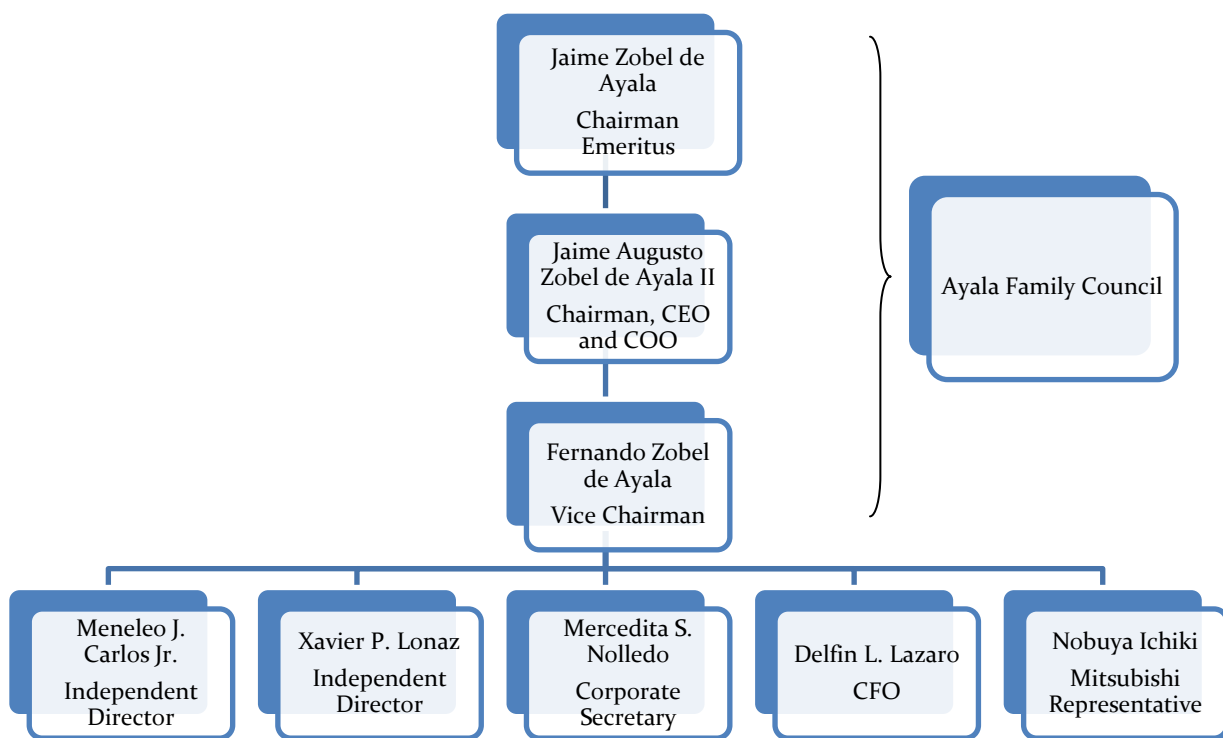


Figure 36: Ayala Corporation -Board of Directors (2009) and Family Council

7.4.5 Ambivalence Towards Independence Directors

Representing minority shareholder interest is a factor in introducing independent directors on Filipino boards. Independent directors are supposed to represent the interests of non-family or non-majority owners:

“The minority shareholders are represented by the independent directors, of which there are two (2) independent directors in the Petron Board composed of ten (10) directors. These two independent directors are nominated by minority shareholders, i.e., holding less than 10% of the outstanding capital stock; and the independent directors themselves cannot own more than 2% of the capital stock in their own right. The two independent directors are members of all board committees and therefore have a say in all matters that are considered by the board committees as well as the main board.” – Petron

For one independent director, he sees his role on the board as representing minority shareholders:

“As an independent director, I see my role, on top of my statutory obligations, as the particular member of the board who asks certain questions: how would a particular transaction benefit the shareholders, particularly the minority shareholders? Is an acquisition accretive to the shareholders? Is it properly valued? Is a convertible issue priced in such a way that it is favourable to existing shareholders? My task is to ask those questions on behalf of the minority shareholders. I believe that our role is to participate in the board discussions. That is my style – where one actively participates.” – Vincent S. Perez, independent director, SM Investments Corporation (SM Annual Report 2006: 75)

However, the highly concentrated ownership structure of most companies in the country mean even international companies appreciates the difficulty of introducing independent directors:

“The independent majority on boards cannot be applied here. If you follow the independent director model, this is contrary to the Philippine culture. People here do not speak bluntly and sometimes are not law abiding.” –private sector 1

For one emerging company, appointing two independent directors is proving to be a challenge:

“We’ve had an issue over independent directors. We currently have one. Within the corporate governance standards we need at least two independent directors. We will be appointing two independent directors sometime this year as under the law.” – private sector 2

However, as a matter of pragmatism, the global business trend towards independent directors is the reality. If a company wishes to attract outside investment, a responsive owner would recognise and incorporate this requirement. This is one indicator of pressures towards the global harmonisation of corporate governance:

“At the end of the day, if the company would like to grow but cannot grow through their means internally, they have to look outside for human and financial capital. External providers of capital from the Anglo-American world would have a checklist such as presence of independent directors.

“As businessmen they will have to go along with the trend of independent

directors. We may not agree with that aspect of globalisation of incorporate Anglo American aspects of corporate governance and independent directors but we have to be pragmatic about it.

“In the Philippines, we push more on director independence in mind than independent directors. All directors have to be independent – it’s the proper thing to do.” –ICD

The concept of independent directors in the country is still very much a reform in progress. However, the Philippines is not alone in this process and given the family-based nature of businesses, it is unsurprising that this has been challenging. But for companies who are willing and are able to embrace this reform, they are rewarded for doing so though the vast majority of companies have to be continuously convinced of the merits of this reform.

7.4.6 Pool of Independent Directors

What was acknowledged by most companies – blue chips and emerging alike – is the difficulty in finding truly independent directors. One view of the introduction of independent directors is that this particular corporate governance reform has created a new market for independent directors:

“Corporate governance may be difficult for family ownership and self-interest but being an independent director is good business now since they are required to be recruited.” – public sector ¹

Family owners are also reluctant to pay for independent directors given that family members (who are also shareholders) can sit on the board at a more reasonably priced basis and would not require the same amount of recompense as professional non-family directors. As noted by one business advocacy group, to exercise true independence, an independent director in the country must be independent in mind and in wealth:

“It’s hard for [independent directors] to be appointed. Maybe [the company] is in need of money for independent directors. Perhaps a truly independent director has to be independently wealthy. For an independent director to be truly different, there are two factors:

1. Financially independent (so the independent director doesn’t need to rely on

the money)

2. Independent in mind

“After you’re appointed [as an independent director] it is subsistence living on [the income of] being an independent director.” –private sector 1

Or as one interviewee wryly pointed out:

“Marry a wealthy spouse to ensure independence.” –private sector 2

The debate over the lack of independent directors in the first place reflects the lack of recognition of the board director as a profession. This was the practical reality when the reforms came in the first place, and the supply of independent directors is an issue that has not abated. While the establishment of the Institute of Corporate Directors is in response to this demand by promoting this profession, the following interviewee reflects the widespread notion that whilst independent directors are a good thing, the reality means the reform falls short of the ideal:

“Here, for example, there is no such thing as a 100% independent director – that [principle] should be revisited. It’s a good thing that there’s independent directors as that is best practice but that is not practical here. The pool of independent directors is quite small – joining from one company to another. ICD is there to train directors who can become independent directors. There is no limit to how many directorships one person can hold although with the BSP there is a ‘fit and proper rule’ which, when evaluated, would limit the number of directorships. There are mandatory two to three independent directors. The more [independent directors] the merrier, the better.” –private sector 3

For banks, the requirement that there must be two independent directors on the board is an issue of resources. For the large banks who can afford outsiders, this is less of a problem:

“Independent directors have no connection with us, are not related to us, and were hired for their expertise. We not only wanted to comply but we also wanted directors who can help the board. Independent directors are good for the company. When they talk, they speak their mind. For [the owner], this is his

flagship so he wants to make it good. He did not want only executive directors because he said they'd only be yes men and agree with him." –private sector 4

But for the smaller, rural banks which are run as family concerns, directors' duties are not well-understood and recruiting independent directors is fraught with difficulty:

"Independent directors are required for all types of banks. This is not so much of a problem for the bigger banks but [it is] for the small, rural banks. It is generally difficult to have independent directors on the rural banks. It is difficult for them to find independent directors as mostly they are run as a family business." – BSP

"Family-owned organisations observe BSP rules but not corporate governance. When I lecture before them, it's all Greek to them. They do not know the liabilities of directors." – private sector 4

The supply of independent directors is also directly connected to the sometime incestuous nature of the corporate elite of the country. Similar to experiences of other developing countries where there is a highly rigid and oligarchical society (Lansberg & Perrow 1991), the pool of Manila's independent directors is rather shallow, thus selecting appropriate outsiders is particularly challenging:

"The rules of the SEC for independent directors are by a process of elimination. There is a negative list of who is or isn't an independent director and you find the independent director if they don't meet any disqualifications on the list. Manila is a small town. People you want to be independent directors have had a connection with [us]. All disqualifications are not present for a person to be an independent director. There is a screening process with the nominations committee, chaired by the board to look for independent directors." –private sector 5

Metro Manila has one of the highest urban populations in the world with some 11 million people. The perception that selecting directors in the metropolis is arduous due to scarcity struck me as rather unusual and even insular. Asking other interviewees about this comment one offered that this is the way of doing business in the country:

"It is a small town. There are all these connections. They just have a different way of running the business." – private sector 6

Another explained reasons of quality, not quantity that makes finding the right independent director for the right company a time-consuming task. Interlocking directorates are the norm in the country:

“There is the general reputation that Manila is a small town. Why a small town? In certain business circles, you meet the same people. It is a high level of concentration. Within the business community you have access to easy information. You don’t need to check the corporate governance of the company – just ask the people in the know. For the companies worth investing in, the reputation is well known. They not only set the standard, they want a name director. The US is just too large an economy but small town America would have the same gossip business columns. It makes sense. The people who affect the life of the country such as the political intellectual circle here is very limited. It is elitist. When I say small, the influentials know each other.” – private sector 7

Offering an opposing view is the SEC. The regulator does not empathise with companies over their struggle in finding independent directors. From the SEC’s point of view, the difficulty in finding independent directors is not a matter of scarcity, but rather reflecting the pre-existing insular, highly concentrated elitist business culture of the country:

“Another issue [companies] bring up is that there is a dearth of qualified independent directors. Look at corporate governance in Malaysia. This is not a problem here because you can pull out professors as independent directors. There are enough people but they don’t want to open up. If they open up, there will be a lot of people who can be potential independent directors – this country has a lot of CPAs, lawyers. But it is matter of time. Some of them came to the SEC and said the SEC should come up with a list of accredited independent directors. We want to increase [independent directors] to a majority of the board. They’ll have to open up or Philippine corporations will be seen as a pariah in international markets.” – SEC

For one business advocacy group, a future reform would be to establish an association along the lines of other independent directors association in the region. This would be one way to promote the independent director as a profession in its own right:

“There is the Institute of Independent Directors in Singapore. We need all of that: minority shareholders, rating agencies. Get our own independent association as the majority shareholder is still the majority.” – business advocacy group

A future independent directors association would represent interests other than the majority owners’ and would formalise and promote the idea of the independent director on company boards.

7.4.7 Number of Directorships

The proliferation of directorships is linked to the perception that there is a lack of qualified directors. Like most countries, there is no statutory limit in the Philippines on the number of directorships one can hold. Only where there is high shareholder activism are company directors seen to limit the number of directorships they have.

Are all directorships granted equally? Is a director holding a substantial number of directorships a working, trophy or token member of the board? Is a multiple holder of directorships a sign of their competence and/or popularity?

Qualified directors are in demand but there are so few of them currently:

“We would like more teeth in the regulatory bodies e.g. core supervision in the public interest such as more stringent requirements in directorships. The joke in [one bank] was it was run as a ‘sari-sari’ (variety) store and run by a barber as that was the former profession of the owner.” – private sector 1

For one company board, most of the members are professional directors hence they hold multiple directorships:

“On the business background [of our board members], the majority of directors are professional directors with one holding 28 directorships. They have all undergone corporate governance training.” – private sector 2

Some interviewees mentioned the ideal amount of directorships and how this ought to be regulated. One interviewee cited resource and time constraints as deterring the number of directorships he wanted to hold:

“I believe a person should have 4 to 5 directorships maximum. If retired from management, professionally. You spend 20-25 hours per month for each directorship studying proposals prior to actual attendance of a committee meeting.” –private sector 3

While another mentioned that a lower number of directorships reflect the perceptive approach he takes sitting in as a director in each company:

“I used to have a lot of directorships – I had 20, but now have 7. I am now discerning from because it’s my reputation on the line.” – private sector 4

For one regulator, limitations on directorships would come under a nominal number and also by industry demands:

“How we can have [this person] hold 80 company directorships - how effective would that be? I’d like to see a limitation on directorships. Maybe a maximum of six directorships. I want a limit on directorships and the type of company. You can’t be a [director] on an airline industry, and be on a pre-need company the next. You need expertise.” – SEC

For Philippine businesses to be competitive and become professional, the dearth of professional directors needs addressing.

7.4.8 Reputation of Independent Directors

Regardless over issues of sample and depth, introducing independent directors has rendered companies to assess the quality of directors they want to attract and keep. Akin to a shopping expedition, possible candidates are assessed according to their strengths, networks, and contribution to the reputation of the company:

“The independent directors at PLDT they are there by strategy. Gokongwei tried to glamorise his [board]. [The company is] operating [the independent directors] as [they] want to operate them. SM is quite open, in more ways thorough but I am not sure who’s an independent director there.” – private sector 1

“[He] was selected by the Governance and Nominations Committee – he is a son of a Taipan – to put new young blood in on the board and to reduce the average age [of board members] which is 60. He is in his 40s. Other nominees include the

former president of the state university, ex-Department of Trade and Industry.” – private sector 2

The quality of candidates for independent directors remains a strong factor for some companies. They must be ‘names’. Candidates who have government connections and international experience are well-sought after:

“Independent directors are nominated by the President. They’d go through a screening process. [We] make sure we have very good names [in the shortlist] and that they are very independent. [One independent director] runs a worldwide operation. While I was in NY, I met him [and] you cannot dictate to a guy like that – he is no pushover.” –private sector 3

“Most of the independent directors have reputable experience. Some come from the government sector. For Manila Water we had the former head of NEDA. Another independent director is the retired CEO of Philippines Shell, Oscar Reyes. Another independent director is a government representative. We try to get a list of nominees, then their resumes and dealings, their standing, then a shortlist and recommend them to the Board of Directors. All of them have undergone a training program for independent directors, to conferences and seminars abroad.” –AC

Unsurprisingly, there is an element of trophy directorships amongst independent candidates:

“There is status [associated] in [the] choice of independent director.” – independent director

A high quality independent director for a highly reputable company is akin to reinforcing the image or brand of the organisation. The right director for the right fit.

7.4.9 Value of Independent Directors

Having a ‘name’ independent director takes greater import when the company is thinking of listing. There is a perceived, intangible market value attached to what an independent director brings.

“When we listed, there were several independent directors nominated. We feel

an independent director of [the company] needs a big profile, what can he contribute to the board? The independent director was organised for the IPO. We had an ex-Secretary [of government]." –private sector 1

One independent director readily acknowledged his market value given his extensive experience and connections in both the public and private sectors in the Philippines and internationally:

"Question: What do you think are the main reasons why you were invited to be an independent director?

Answer: I guess you may have to ask that question from the Sy family; either there was a sense of familiarity with me, or they've heard of my reputation or hopefully my integrity. My feeling is that they wanted someone who could add value to their board. I am privileged to have been invited as an independent director of SM." – Vincent S. Perez, independent director, SM Investments Corporation (SM Annual Report 2006: 75)

The quality and type of independent directors on a company board are also part of the qualitative assessment made by financial analysts in determining the market value of a company. Having independent directors on the company board therefore, attracts outside investment:

"[There are real] independent directors [on] small companies now. They are telling the public – we have more independent directors than before. [So this reform] is filtering to the smaller listed companies. [As a result these companies are] more in the limelight now for the foreign investors than if they were to remain in the shadows [of the bigger companies]." – stockbroker

There is a premium attached to having an independent director on a company board and this premium increases when the company has traditionally been seen as not being transparent.

7.4.10 Independence of Independent Directors

For some interviewees, there was some debate on what constituted independence; whether independent directors were truly independent; and the possibility of having

truly independent directors in the country. The regulator posits a helicopter view on this particular reform and sees independence in directors in the following terms:

“To ensure independence we look at the civil degree: affinity. Not only in a relationship by blood, but also this could be a social relationship. For the independent director the perception is, if you have the relationship - that could affect your independence. As a regulator, we must have specific parameters on what constitutes independence – who can and cannot be. If you’re a regulator, you need parameters. There may not be guarantees but do away with the factor affecting their independence. If you’re a substantial shareholder, it is in your best interest to have representation on the board.” – SEC

The addition of independent directors must be seen in the greater macroeconomic context. If the country is to attract investment, then this particular reform is required. The SEC has taken a strong stance in ensuring independent directors are introduced; not only as a matter of board governance but for economically competitive reasons:

“Some say that it is not applicable [to have independent directors] because the Philippines has family corporations. We believe otherwise. Even if corporations are owned by families, they should have independence from the outside to be competitive.” – SEC

The perception and meaning of what constitutes independence and truly independent is no small matter. The impact was in the introduction, and the devil is in the details:

“Look at Ayala. Look at their independent directors and see who is real – who is not connected at all with an Ayala [company]. Look at Washington Sycip’s background. He is very competent [but he sits on boards who were his] clients before. That is undefined [in what is an independent director]. From Day One [of the reforms] there is no historical aspect. Who is truly independent? Look at PLDT – which ones are independent directors that are not friends of the Chairman and President? It’s hard to ask difficult questions [on independence] here. Who are the real independent directors of corporate governance in the country? To be an independent director is not to be popular.” –private sector 1

“It is not whether independent directors are truly independent. That’s debatable. Independent is subjective as well. You can’t define what it is all about.” –

academic

In applying the independence rule, from a company's perspective there are variations on what constitutes independence and what does not. What is independent to the company may not be perceived as independent in the law:

“In terms of performance, an independent director based on criteria from the SEC, [they are] not officially declared [independent] but in terms of [our perception we consider them to be independent]. They sit on the audit, nomination and executive committees.” – private sector 2

If a director used to be a significant shareholder of the company but is not anymore, then the company can view the person as an independent although regulations recognise that person is not:

“There are seven directors in the company. It was down from nine last year. There were changes in the shareholder composition so there was no need to fill the vacancies. One director was a representative from [a bank] but they've since sold their holdings so they are no longer there. We've also divested from [these sectors]. Most of our board is comprised of independent directors. There are 3 independent directors out of 7. [This director] has less than 5% [ownership of the company] but that's why he has a board seat. [This other director] he's an independent because he doesn't have a shareholding anymore but he is a regular director on the list. He used to have interests in [the company] but not anymore. He is not employee, he is not a consultant. He is the owner of [another company].” –private sector 3

For a small company owner, the question for him is how can a director be independent if s/he is paid by the company for his/her services?

“The independent director is not really independent. The benefits and salaries that they have are tied up with the company. They're serving on the board of directors. I am not sure if any company has been sued by the shareholders or [the suit has] succeeded over the lack of independent directors on the board.” –private sector 4

For one conglomerate, one of their independent directors ended up becoming a working

executive. The company captured their independent director:

“We have only one independent director at the moment. We will move to increase that. He is currently overstretched. The SEC requirement says 20% of the board but doesn’t specify. The board membership is only 7 so slightly we have 14% (with the independent director). [We are] moving to increase the board members. If you go by best practice, you need at least 2 independent directors. There used to be 2. [One independent director] had more work here so he became a working director so we were left with one.” – private sector 5

The corporate governance reform of adopting independent directors has a long way to go before they are truly seen as independent and exercising independent judgment. The notion of what constitutes independence in an independent director will continue to be debated in the country until there is depth in the pool of independent directors.

7.4.11 Independent Directors as a threat

Given the insider culture of family businesses, the reactions by some companies to the introduction of independent directors have been highly defensive. Are independent directors the regulators’ spies in the company boardroom? The untrustworthy agents that threatened families? Several interviewees mentioned the threat posed by independent directors:

“Initially, most companies viewed independent directors as interlopers who know nothing about the business of the corporation, and who shouldn’t be on the board, but over time I think that the benefits of having a fair and objective point of view will outweigh whatever perceived negatives are attached to the position of independent director.” – PSE

For some companies, requiring an independent director is a deterrent to the normal functions of board practice. From one interviewee, independent directors are not conducive in conducting formal board meetings – if they were indeed formal in the first place - due to the presence of this family outsider:

“Requiring outsider directors to be in place? It really is a parody. Most companies put in outside directors, but they’re not. For family-owned corporations, the

board doesn't [even] meet. [The family] publicly hide [their meetings] from [independent directors]." – academic

Similarly, having independent directors on the board are seen as a compliance matter and their possible contribution is likely to be restricted and undervalued by the defensive approach some families have taken:

"Most of the corporations here in the Philippines are family concerns. The major controlling is held in one family. To relinquish decision-making to independent directors, they do so for compliance. Owners dictate." – public sector 1

"There was a sugar listed company. Because of poor governance, it was allowed to be abused by directors and management. The outside directors on the board were unable to perform their role as guardians of minority shareholders. It is currently in receivership, undergoing rehabilitation. Another was a publicly listed bank company which decided to practice good corporate governance with an independent director. [The independent director] tried to fulfil his role along the lines of the ICD training. He was not re-elected again. He lasted a year. He was too independent. An independent director here can't be too independent and be sometimes combative. It would only be a one year term. Your term doesn't get renewed. An independent director can't really exercise true independence if the majority [of the board] aren't appreciative of the role of independent directors." – private sector 1

For companies that have substantial foreign investment, foreign directors on local company boards are seen as independent. A foreign director occupying a board seat would represent the interests of a non-family outsider and his/her movements would send a strong signal to the market– positively or negatively:

"For [foreign investors] that have made an impact look at Kirin Beer of Japan. They put equity into SMC. In the process, they were able to occupy seats on the board of trustees, 20% of the board supposedly. [Their presence] has gone in favour of SMC especially in terms of the shares. If you allow Anglo-American investors to sit on the board in Germany or Finland, the performance of the stock performs better. So, do you allow foreigners to come in and invest and sit on the board? If you allow outside independent foreigners to be members of the board –

it might improve [the prospects of] your company. [However], when [the foreign directors] go out and say bad things are happening in the company – a lot of people would believe him/her.” – academic

It will take time for the majority of independent directors to have their presence from merely tolerated to being truly appreciated for their role and contribution.

7.4.12 The Future for Independent Director Reform?

Despite the dissent over their introduction, both regulator and business advocacy groups are keen on letting this controversial reform stay. Most interviewees spoke about the importance and presence of independent directors in future corporate governance reforms in the country. The SEC is keen to ensure this reform is enshrined in the law as their presence may contribute to a more transparent business environment and change the insular board culture:

“If you are an independent director, you must at least attend a meeting at least so at least there’s [a mechanism in place for] minority shareholder activism. Ensure that some disclosure is made, and there’s a certain degree of transparency. [Ideally there’s] an atmosphere for more company disclosures, and that these disclosure be in understandable language (Plain English), from small and big companies.”- SEC

Furthermore, a future disclosure reform includes emphasising the reasons behind the withdrawal of a director. Resignations by directors in the middle of their terms are rare and in a culture that values face, not seeking re-election is a less confrontational way of signalling there was a conflict in the board or a situation had become untenable for the independent director. From the SEC’s point of view, the withdrawal of a director is a strong signal of the real situation of the company. The reasons behind a director’s withdrawal are usually couched in neutral terms that reflect more on the individual’s personal situation rather than any conflicts one may have with the board. The introduction of noisy withdrawals may increase transparency:

“I want noisy withdrawals – independent directors, lawyers, accountants because of certain policies. They should send notices to the SEC why they have withdrawn. I want a report on the resignation. Noisy withdrawals – reasons like

my health, family matter – they have to be proven to be true. Don't accept the job of an independent director if you cannot meet this. Little things like that.” – SEC

On future prospects of ever requiring a company board that is majority comprised of independent directors, the regulator states that this will be a distant matter given that family ownership and family control are fundamentally intertwined in the country:

“Would there ever be a board comprised of 50%, 60% independent directors? We'll see how it goes. On the PSE board it's moving little by little towards an independent director majority [Washington] Sycip said, we can't import formats and templates [on majority independent directors] – or we'll go under here.” – SEC

This was echoed by a corporate governance advocate that the ownership structure is fundamental to the composition of the board:

“The structure of our economy essentially belongs to family groups. They won't have the majority of the board of groups [comprised of independents].” – corporate governance advocate

The regulator also wants greater awareness and professionalism:

“[I would like to see] strengthening of at least all the institutes [of director training], to have properly trained directors, CEOs and middle management. Not just advocacy but to have independent directors as a profession.” – SEC

This recognises that the nascent reforms in the introduction of independent directors in the country have a long way to go to match the reform by other countries in the region:

“In Korea where their San Miguel Corporation has to have 50% of their board of trustees to have independent directors, we haven't done that. Directors there are going to jail. Any company as big as SMC and half of the board of directors have to be independent. Literally, they must be independent. No cross-ownership. That's revolutionary. In five years' time [I doubt] we would have the Korean model. Things won't change, nothing as revolutionary will happen like that will happen here.” –academic

Taking a more proactive approach on this debate is one leading business advocacy

group. The stance of the group is that giving up on the independent director reform would be akin to surrendering to inferior standards of corporate governance. Hence, while it is difficult for families to have outsiders sit on their company boards, the transition to this particular global standard of corporate governance standards is necessary and worthwhile. Reflecting the cultural dilemmas of converging to a form of global corporate governance standard, if Philippine companies are to attract investment and ensure a competitive business culture, having independent directors on boards must stay and continue:

“The biggest problem [here] is to have complete independence from directors. The separation between Chairman and President is difficult as so many CEOs are Chairmen. The Philippine business is family-owned, and some can’t remove or separate these two. It’s the Oriental system of corporate governance. But it needs some transition. For independent directors – *mahirap*. It’s hard. It’s resisted. It’s something to aim for [to introduce independent directors]. We don’t want that diluted. We culturally aim for it. It is not out of the radar. It’s possible [to have independent directors on Filipino boards]. As businesses globalises we have to compete in a global market so we ought to adopt the [global corporate governance] standards. We have no choice. The market is global. No matter how.

“The problem is with the independent director. Strictly, it’s not independent. Independent by definition in the rule book. But independence in mind, in reality? In mindset? In substance it may not be but [companies] can comply with the rules and you can comply with the rules of independence but not in substance.

“We feel it’s not acceptable for the business environment to aim for a rather diluted [form of corporate governance]. People would say it’s the culture that’s why we fail on practice of [corporate governance] although it may not be under the rubric of cultural difference. Knowing [this to be] a surrender to inferior standards of corporate governance, to be less stricter – we don’t want to give up on this reform.” –business advocacy group interviewees

The following box contains the account of an independent director and his views and perspectives on his role. His story covers issues of personal reputation, mitigating family management-board conflict, compliance versus practice, board culture and improving

board governance. In short, his story is the challenges an independent director on a Filipino board faces should s/he accept the role.

Text Box 7: An Independent Director's Perspective

"I am an independent director on several boards – some are family firms, some are transitioning to becoming a professional family firm. Some are converting from a closed family firm to an open one. Previously I worked in government although I left government in 1996 just before the [East Asian] crisis: timing is everything. Whilst in government, I sat as the representative on a private sector board. I wore two hats – to look after the minority shareholders, and to represent the government.

"After I retired, the phenomenon of independent directors was introduced and people recognised the position as important in the higher order of corporate governance. Hence independent directors are enshrined in the requirements of the SEC. As an independent director, I focus on the interests of minority shareholders to ensure that there are no transactions that can hurt the general public. That is my primary responsibility.

"Companies want a name director. It is not enough to be independent. The companies ask - what does he bring? What type of skills? What value? He must bring value to the company. What are his networks that bring value? The company is a brand after all."

"The role of the independent director is protecting the interests of the public shareholder and taking an impartial role. The people who own the company have superior information. The owners are the insiders – unlike in Anglo American jurisdictions where the insiders are managers. One has to request to be provided the right information and to make an informed judgement based on this information and not be taken for a ride.

"I do not accept a directorship unless the company pays for the director and liability insurance. If management doesn't give you the information then you could be liable. You would be collectively liable. More fundamentally, if management wants to play games, there is self-dealing - they don't want anybody there, it makes it harder.

"For the independent director there is a level of compliance to the letter of the law. But in the context of fulfilling the role within the spirit of corporate governance – some companies simply go through the motions and are not really committed to allowing independent directors exercise their role. I do not stay long in those corporations. My own reputation is at stake if the company doesn't behave properly.

"Do directors resign in the middle of their term? No it rarely happens. There is a sense of delicacy – *delicadeza*⁷². If you're the owner, you don't nominate an independent director who can potentially be hostile. Resigning in the middle of the term is a very hostile act. We emphasis multi-personal relationships and value face. In the case of one company where the directors resigned, the act of resigning was an issue where self-preservation

⁷² The following article provides an insight into the concept of Filipino *delicadeza*: "Redefining *delicadeza* – The business of governance" by Leonor Magtolis Briones (2009) ABS-CBN News, August 17th <http://www.abs-cbnnews.com/views-and-analysis/08/16/09/redefining-delicadeza-leonor-magtolis-briones> accessed 4 September 2009

took over. Being a director is to be conscious of one's reputation and the risk of being implicated.

"The way you're able to leverage influence [in the boardroom] is to work closely with the other independent directors and minority shareholders. A single independent director has minimal impact. But leverage it with others. And set up committees so management reports to the committee. Be diligent in doing that.

"Here, we emphasise the importance of face and relationships. Never confrontational. There is not an active independent director not like the US system. One makes known one's views in a polite way. A formal vote has never been taken. Decisions are consensually taken. Confrontation doesn't happen in the boardroom. If the difference between directors is of a fundamental nature, it does not get sorted out in the boardroom but backroom through a mutual intermediary.

"We are still making the transition to good corporate governance. Most companies you see today have been founded by the grandfather so it's part of the family. There is a change of mindset that is required. Is an independent director a threat to the family business? Yes and no. Some would say it's simply a requirement from the SEC. While some companies appreciate to be professionalised."

7.5 Executive Directors

In professionally run businesses, there are more non-family professional executives than family member executives. The advantages in having hands-on owner-managers are that goals and interests especially on issues of business strategy are one and the same, and that decision making is faster:

"The advantage of a largely family-owned company is having a pool of family members who are owners of the business, and therefore own interests that are aligned with the company...The major shareholders play a very active role in the day-to-day management of the company and we currently have 17 family members working in the group. Of the seven members on the board, five of them are active in day-to-day management. The majority of the board represent over 60% of the shareholders, and this is why the interests of the board/management are quite aligned." –private sector 1

"Family members from both the first and second generation are in their respective areas of specialty such as accounting and focus. Everybody knows what's happening in these areas: It is easy to arrange meetings with the

management team and the product group meets once a month. There is no remote management.” –private sector 2

“One advantage is our management effectively views on shareholder value at the same. Our seniors are owners themselves. They are not looking at shareholder gain as they’d be killing themselves as shareholders [to meet quarterly reportings]. They own substantial chunks. It’s good for smaller shareholders as the management team is led by the shareholders themselves. There is congruence of objectives.” –private sector 3

The disadvantage is owners can blur their directors’ responsibilities with that of managing the company:

“When I came in, the company had no strong controls running the business itself. It is not run like a family corporation but leaning towards that. The difficulty for them (owners) is to recognise the difference between the board and the management. We have the same and one board for both businesses so there is one board to fix the problem in one company. The situation you have is with one board overlooking two businesses, there is the same management but it is run separately. There is a potential conflict of interest, and decision making is blurred as you’re competing for the same clients...There was a general lack of quality as the management was never really good. The owners would be caught in the conflict between ownership and management – it became a vicious circle. The owners were participatory. So once the problems have been fixed the owners have now been hands off.” – private sector 4

“Most corporations are still run like a family business, a ‘*sari-sari*’ store and not professional. Lawyers prepare documents for directors to sign. Corporate governance is not yet part of Filipino corporate culture. The ones that observe corporate governance are the big ones. Big corporations are run by professionals. Others are run by family enterprises, glorified corporations run as a family business. Most are still run as a family business with the driving force being the father or mother. [One bank has] 12 members on the board, each representing a member [and branch] of the family.” – private sector 5

“Yes [the owners are hands on]. (pause). Well not really, [they take] more of a

policy direction. The major decisions are made by them but it's department to department, done by the professionals group." – private sector 6

Too much family involvement may lead to an unprofessional environment in the business (Davis 2008):

"We are fortunate to have professionals as major shareholders as we do speak the same language. Families speak a different language. [Family members] are part-time directors. They're paying lip service [to professionalism]; it's still the family roadshow." - private sector interviewee (1)

Having owners that are hands-off and allowing professional managers to run the business makes a difference in the operations of a company.

7.6 Foreign Directors

Several interviewees mentioned the problems when a board director is a non-Filipino citizen or resident. As some companies have substantial foreign blockholders entitling them to board seats, the residency requirements can be quite onerous, procedural and bureaucratic. The following interviewee mentioned the different residency requirements by professional category:

"As a company, under immigration laws, it is difficult to have a non-Filipino president. Under the immigration rules, they'd only allow a foreigner considered to have technical expertise. We are a registered regional HQ so we are under a complete set of different rules. For the President, the image is important for the listed company. It is important to have the technical expertise. The EVP – any foreigner can apply. An engineer qualifies. The company had a struggle for approval to get a foreign president however it's less of a problem for the Philippine office as the EVP looks after the day to day. With major foreign investors, there is a similar structure and they need to fit [in with the] government requirements." –private sector 1

For another company, the chair is a foreign citizen and nonplussed when he found out certain things were not possible:

"The Chairman got pissed off because he can't get a credit card here and it's

difficult to apply.” –private sector 2

This comment came about after a discussion on anti-money laundering and how for a foreigner it is difficult to open up a bank account in the country.

For companies who bring foreign managers in, the advantages to the host country can be quite positive as the skills and experience outsiders have bring a different perspective. Once those skills are transferred to the locals, the necessity to rely on expatriate management is reduced:

“We also have a management contract with the listed company. For the expat managers we have just under 10 and now it is just under 5. They managed the business but it gives us the confidence of what’s going on that the expat management has now been reduced) and other major Filipino shareholders are extremely supportive of our level of control and discipline that we as foreign managers bring to the company.” –private sector 1

While one is required to always respect the country’s local laws, not being able to bring the best qualified candidates to the Philippines in a straightforward manner can be a deterrent in attracting investment as restrictions on foreign directors show. This also prevents substantial intellectual capital and skills from the international managerial class being transferred locally.

7.7 The Board Committees

The board monitors a company’s management through the establishment of various specialised committees. Both directors and managers are members of these bodies. These committees are the workhorses of the board as they deal with the minutiae of management:

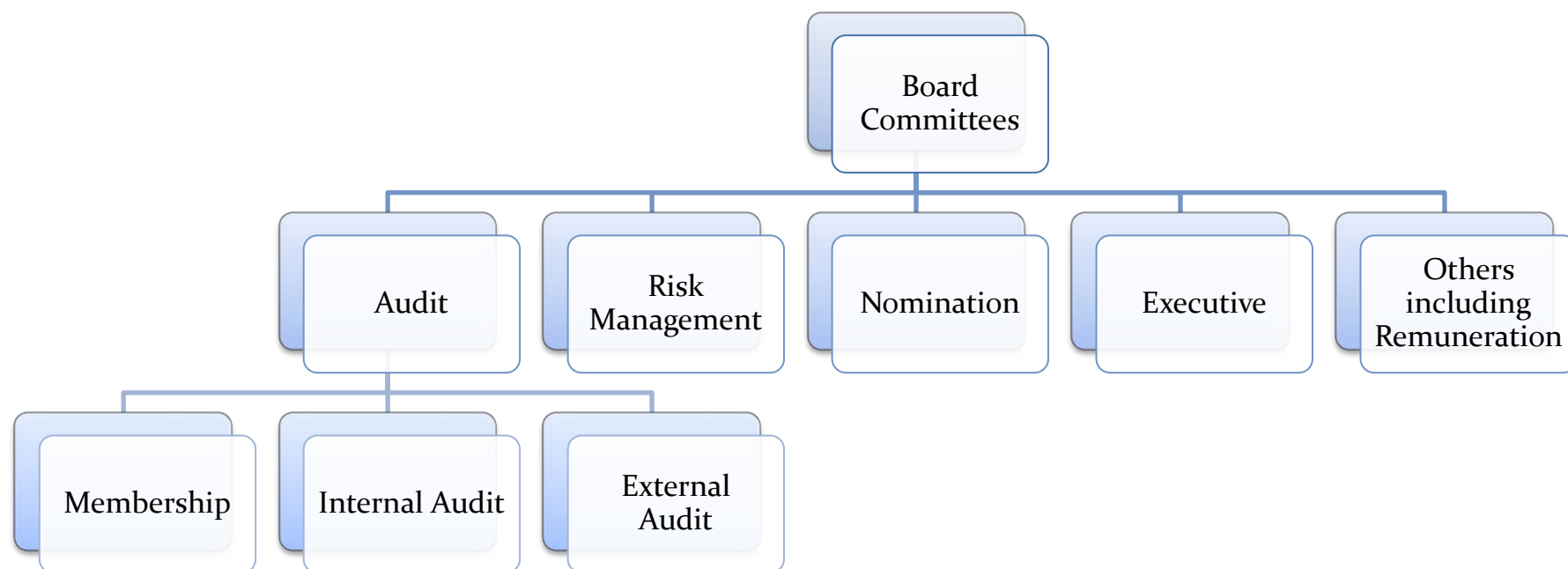
“The board monitors management through regular reporting. The President’s report details everything. There is the financial report of the controller. It takes two hours to study the financial report before the board meeting. All directors discuss and review this report prior to the board meeting. The report contains information on the growth of deposits, past due loans. Apart from the financial report, there are regulations to study. There are also various reports from the Audit Committee, Risk Management, and we have to review decisions of the

Executive Committee. There are other committees such as those that are looking at foreign branches, legal and tax to review legal or tax cases. These are regular items for discussion as part of the agenda. This is how the board closely monitors the activities of the bank.” –private sector 1

“We have a monthly board meeting. All financials and operations are discussed. Operating and division heads present to the board. All major transactions and decisions require the approval of the board.” –private sector 2

In the Philippines, the following figure shows the most commonly mentioned board committees amongst my respondents: the audit, risk management, nomination and executive committees. The audit committee, by far, is the most important board committee overseeing different responsibilities and balancing various interests.

Figure 37: Board Committees Mentioned by Respondents



The following section discusses these committees in detail.

7.7.1 Audit Committee

“The board monitors management through committees. The most active is the audit committee which meets every month.” – private sector 1

The introduction of the 2002 corporate governance code in the Philippines formalised the function of the audit committee for companies and is a regulatory requirement. With formalisation came increased activity in the committee. The regulation surrounding the formation of the audit committee transformed what was once a relatively benign board function into one which allowed external assessment of the company, emphasising the integrity of the process along the way:

“The audit was previously an ad-hoc committee but is now formalised.” – private sector 2

“The [board] committees came into being after the 2002 [SEC Corporate Governance Code]: the audit, nomination and compensation. The compensation was never formalised or not really used. The audit is active every first quarter – it goes through the audit of the committee. The committee sits with external auditors, follow the audit procedures, pass approval and the enforcement.” – private sector interviewee 3

“The audit committee was established before 2001. It was not really active before 2001. Not active at the time. The predecessor of [the current Commissioner] tried to set up the audit committee at the time but it was only there for 6 months...We now have an internal audit committee which is active; it is subject to a commission on audit.” – public sector

For some companies who are on the verge of setting up board committees, the practical matters of establishing these bodies do come into play:

“For bigger corporations, they have the infrastructure in place to implement corporate governance but not for small companies. Mum and Pop corporations cannot come up with audit committee, this is a practical reality.” – IIA

This reinforces the resource and time issue when it comes to establishing board

committees. Companies must seek out what fits them best at their current stage of growth and organisational life:

“We have three committees on the board level. These were introduced late last year: Audit, Nomination/Remuneration (which looks at board membership and executive salaries) and Investment. It is one thing to have immediate requirements - the issue is as an organisation if we are able to do it. Last year we have put in place the process of policies and practices. The practicalities come in to play – if we had set up the [audit committee] immediately [when I first arrived, the company] would have been busy for 24 hours a day.” –private sector 4

The responsibilities of the audit committee are now being appreciated in company board practices:

“With the audit committee, [we are] seeing the start [of good corporate governance]. [This is a] very conscious [effort].” –private sector 5

The corporate governance reforms for the audit committee recognise this body’s pivotal role.

7.7.1.1 Audit Committee Membership

Under the Philippine SEC Code, companies are advised to have in their audit committees at least one independent director and another who has audit experience - preferably both:

“9. Board Committees: The Board shall constitute Committees in aid of good corporate governance.

A. The Audit Committee shall be composed of at least three (3) Board members, preferably with accounting and finance background, one of whom shall be an independent director and another should have related audit experience.”(Philippine SEC 2002) ⁷³

Most Philippine corporations comply with this requirement:

“All [board] committees (audit, nomination etc) must be chaired by an independent director. All audit committees must be chaired by independent

⁷³ SEC (2002) Code of Corporate Governance – II The Board Governance
<http://www.sec.gov.ph/index.htm?ccg/chapter2-ccg> accessed 21st August 2009

directors.” – private sector 1

“Some of the committees such as the audit committee have at least two independent directors. There is one independent director in the audit committee. Most [companies] are complying. The biggest number of independent directors is six independent directors at the Bank of Commerce. But with the merger between Equitable PCI and BDO – a large bank, the [merged entity] will meet more than the requirements.” – BSP

Whether it would ever be feasible or advisable in an East Asian environment to have an audit committee to be entirely composed of independent directors as in Western countries is another issue altogether. However, some have recognised the value independent directors contribute when they sit on the audit committee. For one business group, introducing independent directors is a sign of best practice in corporate governance. Hence, independent directors sit on their companies and committees even when not legally required:

“Integrated Microelectronics, which is an unlisted company, a semiconductor concern, practices good corporate governance practices within the company and in line with the other Ayala companies. They have also created independent directors and have audit committees. With respect to practices, this company has already started good corporate governance even if it is not required as it’s not publicly listed.” – AC

In the case of PLDT, its dual listing on both the PSE and NYSE means their adherence to the latter’s listing requirements of the audit committee exceeds the former:

“Our Audit Committee is composed of three (3) members all of whom, including the chairman thereof who has been chosen from among the members, are independent directors meeting the independence requirements under Rule 10A-3 under the Exchange Act as required by Section 303A.06 of the NYSE Listed Company Manual.” (PLDT 2008)⁷⁴

⁷⁴ PLDT (2008) Comparison between corporate governance standards and practices of PLDT and NYSE corporate governance rules
[http://www.pldt.com.ph/governance/about/Documents/f7933d17962d4b2c942e50ba4980f21bpldt disclosure.pdf](http://www.pldt.com.ph/governance/about/Documents/f7933d17962d4b2c942e50ba4980f21bpldt%20disclosure.pdf) accessed 21st August 2009

However, the chair of PLDT's audit committee⁷⁵ is seen by some as not entirely fulfilling the principles to the letter and spirit of corporate governance:

“The audit committee in listed companies are chaired by directors who have no financial background. The Audit Committee of PLDT is chaired by Father Nebres SJ (Ateneo chancellor) – he has the virtue for being very pious. He is aged 70. But he has no financial background. He may know [financial issues] but we can't profess that [he has the] financial requirements of the job. In other words, it's not conclusive. If we study the function of the audit committee: knowledge of standards, relationships - How can a non-accountant chair the audit committee? Still, you need nuances of front.” – private sector 2

Reiterating the disconnection in the representative quality of an audit committee chairmanship, the following story is from an independent director and his experience of being an audit committee member:

“I was invited to join a board committee by a close friend to sit on their audit committee. I found this committee to be composed of one retired general, myself and another. The Chairman was the retired general. After the meeting I said to my friend that I didn't want to be in the committee after the year was up. It would be a non-working committee with a retired general as the Chairman who had no knowledge of audit. It was command and control. Not an audit committee in substance. It was going to be useless to be a member of the committee. So I decided not put myself again for renomination for the following year as board members don't resign in the middle of their term.” – private sector

3

Furthermore, the requirements for having at least an independent director sitting on the audit committee have unearthed some disgruntlement from family owners on this 'cost' of compliance as it has required some companies to seek candidates externally as internally-generated talent will not do:

“If you look at the investment profile of companies listed on the PSE, only 20% of the top tier can afford [meeting] all the regulations. It is not practical for them to

⁷⁵ PLDT (2009) Committees

<http://www.pldt.com.ph/about/management/Pages/Committees.aspx> accessed 21st August 2009

follow it strictly as it written more for education of corporate governance. It is a matter of culture.” –private sector 4

Audit committee membership has focused on the value independent directors bring to the company. Mandatory requirements mean independent directors on company boards should have strong audit skills.

7.7.1.2 Internal Auditors

The corporate governance reforms in the Philippines have prompted the formal recognition of the internal auditor due to more stringent disclosure requirements. An association, the Philippine Institute of Internal Auditors (IIA), is tasked with continuous education of its members in their internal audit function. The IIA was also instrumental in drafting the SEC Corporate Governance Code. Input from the IIA appeared in the financialisation aspects of the Code such as on the issue of internal control. The IIA plays a corporate governance advocacy role with the ICD and is an active participant:

“We have a responsibility to our members in bringing corporate governance in to the audit committees. Not all companies have audit committees. The big listed corporations, public companies with big shareholders base, 200 members with 100 shares totalling P50M are required to have audit committees and are subject to the same [SEC] circular...partnerships (such as SGV) are not covered.” – IIA

For one unlisted company, the increasing reportorial needs have seen a move towards establishing its own internal auditor:

“This year we are also proposing to have an internal auditor. We decided to have our own internal auditor. We had a dilemma on whether to carry out or appoint an external auditor to do our internal audit, but we decided to appoint our own. The internal auditor will be under another company, it will take another couple of months.” - private sector 1

At the other end of the spectrum, in the Ayala Group, in view of its extensive portfolio of businesses, the internal audit function integrates risk management activities. Internal audit is highly formalised:

“Risk management is also an important element of good corporate governance, conscious of detailing risks in each company. We have established a structure,

enterprise-wide, chaired by the CEO with the Chief Internal Auditor. This committee assists the audit committee of the board of directors to inform not only the risks in holding company but also in the subsidiaries. Monitoring is done regularly.” – AC

For companies which already have internal auditors, interviewees spoke about their internal audit in terms of the frequency of communication with external auditors and the importance of having the outsider’s perspective from an external audit function:

“The Audit Committee meets quarterly or as necessary if there’s an issue with the [external] auditor (SGV)” – private sector 2

“We have quarterly board reports as the board meets on a quarterly basis. They are very lively meetings. The chairman is head of the audit committee. [We] put more teeth in the external audit two years ago and assigned them tasks. The audit committee sits with external auditors. [As a family], we understand the value of these things. [They have] helped enlighten us on the value of a strong audit function.” –private sector 3

The second statement is also an indication of the role of leadership an audit committee plays in supporting the audit function.

7.7.1.3 External Auditors

The importance of the external audit function was made poignantly by one of the regulators I interviewed:

“External auditors are valued allies of regulators.” – BSP

Arguably, external auditors are seen as carrying a supra-regulatory function where a time-poor and resource- limited regulator cannot be as vigilant as it could be over the companies it supervises. Chartered Practising Accountants (CPAs) are seen as exercising an independent role and they are given independent assurance by helping the company. Eventhough the responsibility and the veracity of a company’s financial information ultimately lies with the business and not with the CPAs, the source upon which external auditors base their verification may place this function in a bind:

“You exaggerate performance. An outside capital firm comes in. You exaggerate the tax. You make the poorest statements. You reduce tax (or don’t pay tax). You

don't attract foreign investors. You submit [your financial statements] to the independent auditor. The auditor says ok. That becomes the basis for [financial reporting] to the SEC. That becomes the basis for investors to put money into the company. It's irritating [the lack of transparency]. That's the rule." – academic

The qualifications of external auditors are regulated with a list of accredited external auditors available at the regulators. For banks, the BSP has developed accreditation/selection guidelines:

"The financial statements have to be audited by external auditors and these documents must be vouched for what is contained in the statements." – BSP

For an insurance company, an external auditor would be hired from a list of companies duly accredited by the Insurance Commission as meeting certain standards such as IAS; similarly for listed companies, an external auditor would be chosen from a list of seven auditing firms qualified by the Philippine Stock Exchange. Current corporate governance reforms in the Philippines also require mandatory rotation of auditors though it is seen as lacking substance in its current regulated form:

"You can have the same auditor consecutively for 3 years. You can change auditors intermittently. You pick [the] auditor who agrees with your [financial] statements. Auditor B can't communicate with Auditor A. If B would like to know how A was fired, B can't do that. [It's] more about loopholes." – academic

It was not within the scope of this study to explore the effects of auditor rotation on publicly listed companies in the Philippines. Further research is required to study the outcomes from this particular corporate governance reform.

7.7.1.4 The Big 4

The institutionalisation of audit has seen the rise and power of the established global four auditing firms: PriceWaterhouseCoopers (PWC), KPMG, Ernst & Young and Deloitte. The integral nature of the services the four provides mean companies are reliant on this oligopoly. As in any form of concentrated market power, there are disadvantages. These disadvantages were articulated in terms of cost of the external audit expenses and the practical implementation of new rules:

"We always have issues with auditors. There are always new rules and sometimes

we question those new rules. The audit expenses are becoming higher because of these rules.” – private sector 1

Significantly, for a small company, auditing expenses can be prohibitive. The following account is from the viewpoint of a small company who was dissatisfied with the performance of PWC. This dissatisfaction stemmed from issues such as the membership of the auditing team, costing and the sense that treatment was somewhat different if you were a small company as opposed to a blue chip company (which presumably would also command blue chip prices):

“It is difficult for small companies right now. The expenses of the audits, we have to negotiate every time. Our auditor is cheaper than the big auditors. We’ve found them to be more meticulous than the previous auditor. Whether it’s PWC, SGV – they charge almost international rates but the quality is lacking. These guys [who run] small audit firms are too detailed so they can prove themselves. When we had PWC, there was no partner that got involved and they didn’t have the skills. The auditors we had from PWC were trainees. Then they submitted an invoice that was three times the negotiated fee. I asked them for justification of the new fee amount - they said they spent more time on our audit]. But I have not received any justification. I said to them we agreed that you were going to advise us before. I have paid the quoted price but not the balance as they gave no justification. I asked them to show costings. They must have poor record-keeping or were embarrassed. I asked them to show me the time allocation but they never did.”-private sector 2

The personal touch of smaller auditing firms won my interviewee over:

“So I searched the market place so I found this one small firm, Ramon F. Garcia. Garcia is part of this big religious movement. He’s evangelical. [He has] a strong work ethic. If you wanted to cause fraud, you wouldn’t want to be involve him - he appeared at the audit as well” –private sector 2

Another of my interviewees was also dismissive of the big 4. In an informal exchange he stated, as company chair, he was going to get rid of SGV due to his dissatisfaction over their auditing procedures in a previous company he chaired. This opinion may have been

formed and stemmed from some incidents in the past that afflicted SGV, the local Ernst & Young affiliate:

“[The principal⁷⁶] used to be at SGV and I think was head of the [---] committee and he’d know which firms literally got away with murder – lax accounting, not as dramatic as Enron. But there were some pretty big companies that were involved.” – private sector 3

While having a prestigious audit firm approve the company’s financial statements might not necessarily mean the quality that goes with the perception, nevertheless the cachet a big auditing firm carries mean that having one’s financial statements audited by one of them leads to an amount of recognition nationally, if not internationally. This can be a helpful factor for a company wishing to expand internationally:

“We are not listed although eventually we will list. That’s the reason we’ve hired internationally renowned auditors such as KPMG. They are internationally recognised...we want to adopt international best practices. There are few companies that have that. We try to establish the best business practice. We started thinking big, hence [we have] KPMG [as our auditor].” – private sector 3

While my interviewees had a mixed approach towards the services provided by the big 4, it is foreseeable that their services will continue to be required due to the reliance regulators place on the external audit function.

7.7.2 Risk Management Committee

Complementing the audit committee is the risk management committee (RMC) which may differ in its responsibilities from the former body depending on the company’s needs and scope. At a Management Association of the Philippines (MAP) corporate governance workshop in June 2007, it was impressed upon attendees that managing and being aware of risks are not necessarily negative:

“There is no business without risk. Many opportunities are created out of risk. However, the board needs to have an understanding of risks.”-CG workshop

⁷⁶ I contacted the principal mentioned but he declined to elaborate on this episode due to professional reasons.

Setting up an RMC is a matter of a resource issue and whether there is leadership support for its establishment (Subramaniam et al 2009: 335). According to one interviewee:

“At the end of the day if your management wants good corporate governance, they’ll institute it. I’ve refined our processes, policies. We’ve brought in proper actuarial services to ensure we have proper reserves in company. We have the investment manual, the investment policy. We’ve introduced detailed delegated authority for the board, for the management, for control procedures. We are implementing a risk management framework for both companies. So these cover a lot of things.” – private sector 1

In most companies interviewed, the RMC was amalgamated with the audit committee. In these organisations, the audit committee role carries with it the extra responsibility of ensuring potential company risks have been discussed and measures taken to mitigate them. For one company the decision to establish an RMC was dependent on how the RMC would differ from the audit committee responsibilities. Furthermore, risk issues mentioned were industry-specific:

“We are also looking at a potential, separate risk management committee but that could be consolidated with audit. Risk management overlaps with audit. Risk management in the industry covers product pricing, actuarial reserving, operational risk management and disaster recovery.” – private sector 2

For companies that have separately formed an RMC, there were certain differences in the roles and responsibilities of these two committees. A separate RMC was normally present where the company was bigger, more established, and where organisational complexity required a different committee to thoroughly discuss risk reporting. For one group, the activities of the RMC are described in detail in the following passage:

“The risk management committee sits down with the head of the risk management unit in each of the subsidiaries. There is face-to-face meetings with the risk management officer of the subsidiary and what possible risks are involved, what possible solutions and exposures are involved. This is collated and reported to the holding company, and after, a report is made to the audit

committee, and then it goes to the board level. This is an effective oversight function and this has been established for the last two years since 2005.” – AC

The East Asian Crisis was the catalyst for establishing an RMC for one company, as the crisis raised awareness of risk management:

“As a result of the East Asian crisis, we have instituted a financial risk management system throughout the group, to address foreign exchange risk, liquidity risk, and interest rate risk.” – private sector 3

“After the East Asian Crisis, corporations became aware of what risk management was all about. The East Asian Crisis showed there was more to business risk than with financials. It prompted a bigger picture of [the type of] risk [that] can happen. [It’s] not only [about] operational risk, but currency, reputation, political and industry risk. Other forms of business risk in a larger scale. How to manage risk? [There is a] new jargon of risk management, broadened to enterprise risk management due to governance issues, [there is now] talk about managing the business risks.” – private sector 4

The BSP, the most active out of all the regulators, have also taken a more stringent approach in risk management for the industry and the Central Bank issued guidelines based on the Basel II framework⁷⁷ prompting all banks under its supervision to establish an RMC. An example of corporate governance reform by committee was articulated by the following banking interviewee:

“After the BSP issued its guidelines based on Basel 2 compliance, the following committees were established at the DBP: Risk Management (2001/2002), the Governance Committee (2001/2002) and the Audit and Compliance [committees] were merged. Five committees have since been established after Basel II - the number of committees has doubled. The concept of risk management and the concept of good corporate governance, transparency, disclosure and financial reporting have since been [formalised at the DBP].” – DBP

The RMC ensures companies are well aware of the risks they face and ensure mitigation strategies are in place to meet them.

⁷⁷ Basel Committee on Banking Supervision (2009b)

7.7.3 Nominations Committee

With the 2002 corporate governance reforms and the mandatory introduction of two independent directors on Philippine corporate boards, the nomination committee has become formalised for most companies. The nomination committee is preoccupied with undertaking the process for which candidates qualify as an independent director in order to meet the compliance requirements. Regulations from the SEC under Rule 38, Section 8 of the Securities Regulation Code (see Appendix 5) provide guidance on the composition of the nominations committee. As a result of these reforms, the nomination committee has become a more rigorous decision-making body requiring more formal discussion and processes:

“There is a nominations committee. Before the AGM, the nominations committee [convene], pre-screen candidates and submit a shortlist of [members] to be nominated. The nominations committee is composed by three members of the board and HR.” –private sector 1

“In the past, people stood up on the floor, nominating a person to be a board director. Now, the nominations committee deals with that. The committee will certify nominees. The nominees must have all the qualifications without disqualification. The nominations committee will nominate directors.” – private sector 2

“Two (2) out of ten (10) directors are independent directors; they are nominated through a nomination period which lasts or one week and is announced in the newspapers; nominations for independent directors are screened by the Board nomination Committee and endorsed to the Board for the election at the annual meeting.” – private sector 3

The nominations committee can also be a battleground for potential contenders:

“All directors are nominated by shareholders. The nominations committee go through the process not to count the vote but to ensure those have been nominated to qualify reach the AGM. If there are 12 nominees, by the AGM we go through the vote process of getting the vote down to 10 directors. [There are some] pestering lawsuits [over this issue.]” – private sector 4

For one growing company, the committee has sought candidates nominated by the public with little success:

“We’ve accepted nominations from the public but none have come up as people with experience. We do our homework, and we look for outside experience. For example, we are looking towards [those with experience of] risk management, tax, SEC regulations, audit, market, networking, financial management.” – private sector 5

The ownership structure of most companies also mean that potential independent directors must have cultural fit with the sitting family board members:

“Directors are elected by shareholders. The code of corporate governance requires all directors must be screened. [The nominations committee] determine [which potential board members] have all qualifications and none of the disqualifications [of being an independent director]. There is a provision enumerating all this in submitting nominees. [There is a shortlist from the] nominations committee, [which is then] submitted to the board. [Directorship] tenure is normally a year. In the case of three members of the holding family, they have been [board members] for the last 10 years.” –private sector 6

Exercising its control in this committee, the major shareholder generally nominates the candidates for directorship:

“We have a nominations committee but in reality the nominees come from [the owner]. He consults people. Frankly, the Chairman decides who should be the members of the board.” –private sector 7

“We have two dominant families (who are owners), they choose representatives to sit for them on the board. It’s not [the owner] sitting on the board, it’s his choice of representative. There’s a lot of consideration on who would be a director. The director is renominated ever year.” –private sector 8

More significantly, being nominated to a directorship is considered an honour and privilege. The following text box relates the concept of the board as the inner sanctum:

Text Box 8: The Inner Sanctum - Issues and Conflicts

“Family firms are notorious for investing in the ‘values fit’ of new employees, new directors on the board, even new strategic partnerships.” – Ward (2008: 4)

How a director in the Philippines is nominated to a board is culturally defined. When you join a board – the inner sanctum - you are joining a family. By extension, you don’t betray your family.

The Philippine concept of the board as a family is sustained in an unstable environment because the lack of strong civil institutions in the country render the family the institution which best provides solidity and reliability.

In the family-oriented culture of the Philippines, a board membership is an honour because the implication here is the Chairman has personally chosen you to join his/her board, which is an extension of his/her family. When you resign from the board you are showing disrespect to the Chair. If you leave the board abruptly, that can be construed as a hostile act and in essence you are betraying the family. As the following interviewee points out:

“It is about Asia here. The culture is non confrontational unlike in Australia where you call a spade, a spade. All boards try to become polite. It is difficult for directors who have a differing opinion to present their views. A director does not resign in the middle of his term as this sends out a signal to the market – to resign is impolite to the Chairman who most of the time has chosen you to be on the board, to join the family. The board values harmony. If a director wishes not to continue his tenure, he asks not to be renominated. They don’t step down in the middle of the term.” - ICD

Equally, the omnipotence of the Chair also means that if s/he is displeased with the performance of a director, then the member’s days on the board are numbered:

“Directors are elected so technically they exercise on behalf of the shareholders but in practical terms, the chairman controls. If he’s unhappy, he won’t renominate a director.” –private sector 1

In this culture, there is conflict where the interests of the independent director in representing minority shareholders may not share the interests of the majority shareholders. The term ‘*pagmamalasakit*’ came up during a corporate governance workshop. The comment came from a family owner who was having a hard time understanding the professionalisation required for family businesses. This word translates to deep concern or empathy. The justification is that because the family are owners, their money is invested in the company therefore one has personal affection and involvement with the company as opposed to having outside professional directors who have no family connection but can see things more objectively. The self-interest in ensuring the company is run well is due to the owner’s own interests as opposed to outsiders who do not have the same embedded interest.

The way board members are nominated, the possibilities of compliance conflict vs. the family conflict is extant. There is a compliance conflict because regulations state independent directors must sit on the board. However, by joining a family-owned and family-run business, the unwritten law states you are loyal to family members because

the board is your family. In most companies there are family members on the board so the board is a true extension of the family. Incoming non-family members need to be trusted before they are invited to the board. Board members who join are treated as family members. This is a cultural norm which ensures 'independent directors' or directors independent to exercise their duties a challenging task.

Nevertheless, the perception of the board is undergoing change in the Philippines requiring a more emotionally distant and professional approach from members. Whether such a level of distance and professionalisation could be achieved will largely depend on the changes in ownership structure and the family culture within the business.

The introduction of the independent director has propelled the nominations committee at the forefront of board concern.⁷⁸

7.7.4 Executive Committee

As a committee that is compromised of senior managers of the company, in one business group, the executive committee is the forum for addressing the strategic operations of the company. For another, the executive committee also fulfils the role of the board when the board cannot exercise its duties.

“In the absence of the board, the executive committee under the by-laws can perform delegated authority from the board. The executive committee consists of the CEO, President and [major shareholder] representative.” – private sector 1

The above comment supports Kesner’s observation (1998: 83) about executive committees. As the majority of board members in the Philippines are company insiders, there is some overlap with the membership of the executive committee and the company board. The board is generally seen as being tasked with reviewing corporate strategic decisions of the executive committee:

“[After] executive committee meetings, the minutes are given to board members. The [board members] are given the opportunity to comment on all actions of the

⁷⁸ This is not necessarily a disingenuous factor in improving and promoting the company director as a professional occupation as Cadbury points out: “An advantage of having a formal nomination committee is that it provides a forum for carrying out such reviews and for doing so regularly, not hurriedly when the need arises.” – Cadbury (2002:120)

Executive Committees. Four of the members on the Executive Committee are members of the board.” –private sector 2

“All actions taken by the executive committee are submitted to the board of directors in regular meeting for ratification. With any disclosures management must submit to the regulators, management must email all members of the board informing them beforehand.” –private sector 3

This brings an interesting perspective on where the real decision-making lies in family-owned businesses: in the executive committee or the board? If important strategic decisions are made in the executive committee, there may be better use of the board’s time beyond the review and ratification of the committee’s decisions.⁷⁹ This overlap of responsibilities prompted this statement from one interviewee whereby the executive committee was seen as unnecessary:

“We have regular board meetings – quarterly – so there’s no need for the executive committee.” – private sector 4

Future research could explore the intricate nature and separate responsibilities of the board from the executive committee. For example, to what extent does the board overrule decisions made at the executive committee? In an insider-dominated board, how do an executive committee’s responsibilities differ from that of the board? How does this differ from outsider-dominated boards? There is currently a dearth of knowledge on executive committees and future research may yield a different way of viewing the relationship between this committee and the board.

7.7.5 Other Board Committees

Other board committees mentioned by interviewees include industry specific committees (such as technological or technical committees), those relating to business group structures (finance or investment committees) and the remuneration or compensation committee. In one company the remuneration committee is combined with the nomination committee:

⁷⁹ As pointed out by Cadbury, “The management proposals which come to the board have probably been thrashed out at an executive committee chaired by the chief executive. If the chief executive is then in the chair at the board, it requires a deliberate effort on their part not to have a rerun of the executive committee discussion.” (Cadbury 2002: 112)

“The [combined nomination and remuneration] committee looks at board membership and executive salaries.”- private sector 1

In Philippine boards, the nomination committee is seen as the more influential and powerful committee than remuneration. Executive compensation is almost seen as an operational afterthought. Astronomical levels of executive compensation are not a corporate governance issue in the Philippines. This contrasts positively to public outrage and anger at senior executives in Anglo-American companies⁸⁰:

“Executive compensation is not such an issue as the executives here do not receive as high [a compensation as in] other countries.” – private sector

Excessive Anglo-American executive salaries are largely unheard of in the country, and as a consequence this committee is underutilised. Interviewees stated that meetings by the remuneration committee were “rarely convened”, “met annually” and “never formalised or not really used.”

Thus, with regard to board committees in Philippine corporate governance, the remuneration committee is not seen as a powerful or influential committee as it is in Anglo-American companies. This is simply due to the reality of Philippine corporations where families are the largest shareholders and executive pay is kept in check.

7.8 Culture and Conduct of Board Meetings

The boardroom is still largely seen as the domain of an elite boys’ club and the following comments reinforce this perception:

“Relationships are important here. We value relationships – members of the board are personally related in terms of business, ex-classmates. We value relationships which is common here in Asia. This is an obstacle in terms of governance implementation because with relationships, people are not open to making disclosures.” – private sector 1

“Our board is governed quite well. The board don’t see the formality, preferring to run with less formality as by and large they are all friends...The board meets

⁸⁰ Executive compensation remains a sore point and sensitive issue in the reform of Anglo-American corporate governance. See Clarke (2007) *International Corporate Governance*, London: Routledge

every 4 months, most of them are semi-retired. The Chairman lives in Hong Kong. The local directors, others reside here.” –private sector 2

However, corporate governance reforms have seen some changes in the culture such as moving towards a professionalised board and having formal procedures in board meetings:

“We are influenced to do things. In the conduct of board meetings, we are now more formulaic, for board meetings we require all board recommendations to be given to all members 10 days before the meeting. [This gives board members] enough time to read [the recommendations] and be prepared. So in meetings we are prepared, questions of discussions. I am the ‘*sacristan*’ or workhorse in preparing the agenda – the proponent. Clarificatory questions are held before the meeting. This has had an impact on the conduct of the board meeting.” – corporate secretary

The comments from interviewees in this section are insights into how board meetings are conducted. They reflect each company’s ownership structure, the commanding presence of the chair, the culture of the company and its sector-specific situation.

The following account comes from a CEO who sat on different boards – both government and private – over the years. The following is his impression as a former independent director of a listed conglomerate and how board meetings were not exactly the professional discussions he expected them to be:

“I complained about receiving a two-page financial statement when it was given to me. As a big company how can you have a two-page financial statement? Also we had two-hour board meetings per month. Lunch was included in the two hours. I got paid P10,000 per month as a director. I was also told that I had asked a lot of questions and this had not happened before. When I sat on a government board, we had boardroom fights but we were friends afterwards. Totally different culture.” – private sector 3

As the concept of a ‘professional board director’ is quite nascent, those who receive directorships as a matter of prestige or are trophy directors tend to confront other directors who ascend to the board as working directors. Striking the balance between both sets of directors make for an interesting board composition as the following

observation related by a director who realised his peers were not qualified to discuss complicated financial issues but were more than able to channel their energy to discuss the perks of a directorship:

“When I was sitting on a Financial Committee, there were two items on the agenda. The first item was about a new car each director was getting. The second item was about a complex financial issue. It took five minutes to discuss the complex financial issue. For the car, the discussion was one hour as it was easier to understand and people were exchanging opinions about the dealership, the type of car, the concessionary etc.

“For the board, they wanted something easy to understand. For the car, it was difficult to make a quick decision because the committee understood the issue. In a board, if you have a 70 year old accountant, they won’t know much about current developments in standards or policies.” –private sector 4

How to discuss sensitive strategic issues when the family owner is present is a major block in having professional board discussions as pointed out by the following interviewee:

“The culture prevents independent directors or independent-minded directors to raise questions during the board meeting as the meeting is there to bask [in the glory of the] CEO, Chairman. [The board] is not comfortable with [confrontation].” –private sector 5

Criticisms are compounded when there is the unprofessionalised family board and there is no disguise whatsoever of the distinction or separation of the family from the company. Board meetings are not held whilst fraudulent board meetings are invented to meet SEC certification compliance requirements. A board comprised of insiders accordingly will test the enforcement and regulatory capacity of the SEC:

“Some of the family corporations do not really have formal board meetings. For example, some satellite companies don’t follow corporation rules but have informal meetings.” –private sector 6

“Most of the SME boards don’t meet. Most boards don’t actually meet. [The] extras (directors) are friends, relatives. Management needs them for [compliance]

requirement as many boards don't meet. [Management] circulates resolutions for the board to sign. [They] ask the corporate secretary to sign for meetings [that were never] held. Even in a large family [company] this is the case. The publicly listed [companies] demonstrate good corporate governance [by having independent directors] because they select [those directors] who will agree with family members." – academic

From one end of the spectrum to the other, the following account is from a listed professionalised company run by a professional non-executive chair showing the formalised procedures and manner of conducted meetings:

"I conduct board meetings early. I made them an hour early in 2007. Here the President made the Filipino directors come and do something as they were only coming here to get their per diem. We have military people on the board so they do turn up on time for a 10 am meeting. If there's a quorum already then I'll kick it off. We follow basic good corporate governance principles.

"We have HR&OHS, RM and audit reports. There are 6 boards meetings per year. We discuss what the challenges are in the industry, if the marketing plan is on track. In August we'll have a 5 year planning for our projects. There will be a presentation on budget and tax. We review the listed company on an annual basis.

"There are also [industry] issues: they rely on me and who are in the business and the industry. I tend to leave the day-to-day [business] to the President. The board meetings tend to last for three hours long." – private sector 7

The motivation behind running a professional board was imprinted on this interviewee while attending a corporate governance course. This had an effect on his perception of how boards should be run and his expectations from board members:

"One speaker said: If you sit as a director, there's a general principle. Have a feeling for what is going on. A feeling for the business. You can't afford to sit there and do nothing. Have the courage to challenge. Don't go to the meeting to make the management feel small. You can't let management steamroll you into doing the same. Be pretty vocal on the various boards. They (directors) hate to lose face. With face, I don't care. I don't worry too much about it. Fortunately at

the listed company board, they (directors) read the board papers. There are a lot of meetings where they don't read board papers. So here they ask good questions. Have the courage to challenge." –private sector 7

Having intact human relations or *pagkikisama* and emotional intelligence reigns supreme in the Filipino board culture:

"The advice HR people give – you give bad news sandwiched between the good news. In between you give them hell, but give the book ends a good stuff. A pat on the back. There is the emotional quotient: bridge the emotional divide, sympathise with you. There are consequences of not meeting deadlines. Criticism is not well accepted here. You need to bridge emotional gaps and empathise with their needs." –private sector 8

Given a choice between making difficult business decisions that could lead to conflict and a culture that emphasises consensus and harmony, pragmatism dictates when there is a little compromise, it is better to err on the side of the latter.

7.8.1 Board Culture in Contrast

In contrast to the Philippines where formal voting on the board level is not known to occur, Australian board culture does formally allow for dissent and contrasting opinions amongst its members. Hence voting is seen as a necessary tool to mediate conflict on the board level. How Australian corporate boards handle conflicts and potential issues that could split a board can be seen in the following two examples (see box). One was a board which badly handled the issues facing the company, the management and the board – necessitating the departure of several board members and senior management. The other was an exemplary board which handled a divisive issue in a professional, organised, and meticulous manner. The following text box contrasts the distinct board cultures of these two company boards.

Text Box 9: A Tale of Two Australian Boards

"The board of directors is...seen as the place where conflicting interests are mediated, and where the necessary cohesion is created." (Corbetta and Salvato 2004: 124)

Foreign Exchange Trading Losses and the NAB Board

In mid-January 2004, the National Australia Bank (NAB) disclosed that four of its foreign

currency traders lost the bank \$185M. A week later, this loss doubled to \$360M after further “concealed loss-making positions” were uncovered (APRA 2004: 15).

To investigate the fallout from this enormous failure and the weaknesses of the company’s internal risk management procedures, audit firm Price Waterhouse Coopers (PWC) were tasked with handling the inquiry (PWC 2004). However, this did not receive unanimous support from the board. Conflicts of interest issues arose as PWC and NAB had several business relationships including one board member’s previous employment as senior partner at PWC: “essentially PWC would have been investigating their own work.”(Thomson 2006: 20)

Other issues emerged relating to board members’ roles on the risk and audit committees, and the inefficacy of a director’s oversight responsibilities to miss the glaring loss. The following month, in February 2004, CEO Frank Cicutto and Chair Charles Allen resigned as NAB took a battering to its once sterling reputation. Dissatisfaction and dissent in the NAB boardroom became public and extensive business media coverage ensured the NAB board in its then dysfunctional form was untenable. One director, Catherine Walter, was singled out as a ‘loose cannon’ and pitted against the interim Chair, Graeme Kraehe.(Askew 2004)

An extraordinary general meeting was called by other non-executive directors to vote Walter off the board. Walter countered by proposing that all independent directors (including herself) not seek renomination at the end of their terms. The decision on the composition of the NAB board was now in the hands of the outsiders - the shareholders - who were mainly composed of institutional investors. This was seen as an unsavoury prospect and provoked questions over the limited responsibilities of a bank’s institutional shareholder:

“As a nation we still lack a culture of shareholder pressure and a culture of corporate accountability amongst non-executive directors. Part of the problem is that NAB pays huge fees to third party fund managers through its giant MLC division so institutional Australia is very reluctant to upset the bank by voting against a director. This is a good example of why Australia needs a church and state type separation between big banks and fund managers. You can't provide the debt and equity for an economy.”(Mayne 2008)

The bloodletting over this episode saw the departure of four board members including Walter and the arrival of eight new board appointments. Kraehe left the following year (Murray 2005). Indeed, in its Annual Report for the year, the bank released the following understatement:

“The [NAB] Board has undergone significant transformation during the past year.” (NAB 2004)

In contrast, the next section relates how another difficult board issue was handled in a more positive manner.

Succession Planning at the BHP Board

In 2009, the BHP board faced the imminent retirement of its highly esteemed Chairman, Don Argus who in a previous professional capacity was a CEO of NAB of the preceding case (Gottlieb 2009, AFR Editorial 2009). Succession planning was formalised with a global search for a successor occurring over a period of 18 months. The procedure in

transferring the position of Chair to another has been called as reflecting:

“...the structural integrity of the succession process Argus has run here. The first thing to note is that while this process has been done in his name, he has been largely removed from it....Argus is, quite plainly, very determined to make his final succession plan an utterly certain, seamless affair.” (Stevenson 2009)

The search was conducted by an outside executive search firm and the choice came down to two candidates. The board was split in this decision and to resolve this conflict, the new chair was decided by “the unusual method of a secret ballot amongst the board members to prevent lobbying by candidates.”(O’Doherty 2009)

Demonstrating the lack of consensus amongst the board members and mitigating any destructive behaviour that could undo the professional manner in which the transition was being handled, the board brought another outside party to administer the process.

“BHP used KPMG as the returning officer in the ballot of the 14-strong board and only KPMG knows how the votes fell.”(Fitzgerald 2009)

“The decision to appoint Mr [Jacques] Nasser was agreed by the Board following an 18 month selection process. The international recruitment firm, Heidrick & Struggles, was engaged as independent adviser by the Board to assist the Board in its deliberations and consideration of both internal and external candidates. KPMG supported the final process as scrutineer.” (BHPBilliton, 2009)

The process, described as unique, is rather uncommon in Australian corporate boardrooms. A financial commentator expressed his incredulity over this episode:

“An international recruitment firm was engaged as "independent adviser" to assist the board. And most bizarrely of all, accounting firm KPMG "supported the final process as scrutineer". What are we talking about? An ALP [political party] pre-selection process? Counting the votes on the Brimbank council? I've never seen anything so extraordinary. OK, we might have moved on from "Jac's a good fellow, we can't have that Sydney chap". But scrutineers? Might one of the fellow board members be thought likely to discreetly stuff the ballot box in, again, a secret ballot as the port was passed?”(McCrann 2009)

Thus, the sensitive issue of succession planning – which is pertinent in a company be it family-owned or otherwise - in this case was done well and above board in a highly formalised manner. This was corporate governance practice in form and substance and one example of a successful succession plan executed in an Anglo-American corporate governance environment.

7.9 Professional Management

This section covers professional management and director training.

Professional managers exist in most companies I interviewed. Professionalisation has a lot to do on whether different family businesses grew and expanded successfully or unsuccessfully. One interviewee stated that professional management (or lack thereof) is reflective of the country’s economic development:

“The Philippines is at an early stage of development. The corporation is an artificial logical creation. In developed countries, the corporation has professional management. Here, the availability of finding ownership and management it’s still at an early stage. It’s partly cultural. The family [is dominant here]– still family-centric. [The] USA [was at this stage] at an earlier history.” – private sector 1

One regulator pointed out that a distinction must be made between those family-owned companies which are professionally-run and which are still family-run. This difference is crucial in the competent running of a company:

“Family ownership in most corporations it is not necessarily bad. It’s when ownership overlaps with management that brings about conflicts of interests. One of the bigger banks of the Philippines – BPI – is controlled by the Ayala group. But the management has been professionalised. The biggest difference is with ownership and management. There is nothing inherently wrong with family. But there is an emphasis on the separation of the nature of ownership and the management of the boards.” – BSP

If the family does not professionalise, then family conflict comes to the fore:

“What the founder established, [there is sometimes a] lack of leadership. If you can get professionals, [let this process be] started by founder. If you don’t have professionals, the siblings bicker. They spend all their energy fighting each other than running the organisation.” – private sector 2

To mitigate inter-family conflict, siblings are given different positions within the business:

“There are companies that give positions to siblings. There is a good mix in [this] Group. There is a strong personality of [one brother], no problem with that one. [He] doesn’t just give jobs to [family members] first. [They don’t] sit on board. [Another brother] has a chemical engineering degree; [The other] had experience from US corporations. He trains them and gives them a responsible job. He’s built it so they have professional managers. Their bank is being run by [a non-family member].” –private sector 3

Interviewees who spoke on this subject were cognisant of the reality that the family gene pool can only produce so many competent managers. One expanding family-owned and controlled company appreciated the need to professionalise to secure the long-term future of the business. A growing family operation needs to go outside to expand, and to start trusting outsiders with the business:

“On succession planning, it is not wise to plan in such a way that people from the family run of the business. We might run out of talent in-house. The challenge is looking for good professional people to help us in running the company. We are lucky to have [a non-family member executive.]. [Professionalising] is a big challenge. We are running the company and it is heavily dependent on R&D on product application. We are strong there. We need capable people. [This is] the challenge for family.” – private sector 4

“The investment-enlightened are intent in attracting good, professional managers, whether or not they’re family. The statistical odds that [all professional managers] would come from one family are low. For family groups, it makes sense to bring in professionals. [You are] putting too much at risk on a family basis.” – private sector 5

Even for one business group whose principal does not have the reputation for practising good corporate governance, professional managers are also in place, perhaps in view of the forthcoming succession process:

“With Lucio Tan there is a misconception about him. He is a highly centralised man but he hires able lieutenants. He buys talent. He does have professional people. Lucio got one of the top [executives] from Robinsons to head the Eton Group [Tan’s property group]. He’s the be-all and end-all. He has the professional management in place.” – private sector 6

For one company which recently professionalised, there are certain advantages and challenges that the family and the company face in the transition from being a wholly family-run and controlled enterprise to one where the family owns the business but professionals run the company:

“Advantages: Most companies in the Philippines big and small, are controlled by families. In the Lopez group, since there are only four (4) second generation

family members who meet, decisions are done much faster and execution by the professional executives is supported from top to bottom.

“Challenges: There are family members who head some of the companies under the group and accountability for performance can become an issue. In order to avoid conflict among family members especially when the 2nd generation family members decide to retire from management, the challenge is how to transfer all the day to day management responsibilities to the professionals, and yet for the group to continue to have the valuable services provided by family members in managing the different businesses .” – BenPres Holdings

For the longest continually run business house in the Philippines, each generation has had several family member-managers represented in the companies but for the most part, professionals have run the companies. The ability of the family to engage in successful formal succession and mitigate any negative effects is a strong contributory factor:

“Through the years, this has been built up to be a representation of a family conglomerate. We all see how after the third generation, the business dissipates. This is the 7th, 8th generation. Fortunately, successive generations were visionaries with succession that AC should be sustained as a profit making company with social awareness. We give credit to the family for its successive generations. It has been transferred from one generation to another.”–AC

One interviewee mentioned the group when discussing the benefits of professionalisation on family-owned companies:

“The Ayalas survived due to sound and wise succession planning. They have taken good care. I’m able to stay on. Even though there are many owners, only two of the family members take an active role.” –private sector 7

Another concurred with this assessment but pointed out professionalisation is an enormous challenge for a family business and not all family-run companies can integrate them effectively:

“I’m happy to see companies are professionalising. At certain [times] professionalisation of [a] company’s development [happens]. A good example is

the Ayala Group. Ayala is a very professional organisation. It set up Globe, it didn't put a family member to head it. They had someone from the professional ranks. That's what distinguishes a family corporation that is professionally run versus a family corporation that remains family run."-private sector 8

Failure to professionalise affects the viability of the company to operate in the future.

"The [companies] that have grown have professionalised. Those who insist on having members as core officers have remained small entities." -private sector 9

Professionalisation represents maturity in a family-owned business and professional managers bring an economic value to the company that is appreciated by outsiders.

7.9.1 Professionalisation and Corporate Governance

Most of my interviewees were formally trained overseas and therefore their understanding of corporate governance was seen in a more positive light:

"If you look at the executives of (blue chip) corporations, most had overseas training in how they run companies so they are educated in the governance sense. Most of my [business] background, the corporations that I have worked with have been major MNCs – essentially all foreign corporations. All have had corporate governance guidelines guided by their country of origin listings. I have grown up with this discipline [of meeting corporate governance standards]." – private sector 1

The professionalised family-owned companies are considered the best run businesses in the country and are therefore more willing and likely to include corporate governance practices in their companies:

"For George Ty, Metrobank is his flagship. Federaland (property) is a secondary business. This is his company and he wants it professionally ran. This is sacred and there is no hanky-panky and everything must be above board."⁸¹ – Metrobank

⁸¹ Another interviewee pointed out that Metrobank suffered in the aftermath of the East Asian crisis. However, unlike other banks, Metrobank was highly capitalised which made it weather through the storm. After the crisis, there were strong moves to change suspect practices and the family and its attitude towards the business had changed since.

“The best run companies have professionals. There are generational differences: the young are interested in corporate governance and they expand to master business practices. Patriarchs are uninterested – partly unexposed. [With the] business environment, [there is a] bit of an assumption that enough of that [knowledge is sufficient]. It is routine. [However] if they’re 2nd, 3rd generation, they are interested in such issues. They are able to persuade to participate. They are intent on professionalising, not unlimited to corporate governance or unduly corporate governance.” – academic

There is a strong link between professionally run businesses and a positive appreciation of corporate governance practices.

7.9.2 Value of Professional Managers

In practising good corporate governance, both the tangible and intangible value of professional management is recognised. Throughout my interviews I spoke with some highly capable professional managers with a strong vision for the company and clearly defined roles within the company. My interview notes bear this out:

“All my questions were answered by [my interviewee] and there was an openness that was missing in some of my other interviews...At the end of the interview, he and I discussed the relative merits of the condominiums around Makati...Overall, this interview, which lasted around 2 hours, was very fruitful. The contact with him earlier in Sydney provided an ease of transition to the face to face interview...My opinion is [his] direct forthrightness and frankness stemmed from the company’s vanguard position. There was a good rapport with this interviewee.” – AC interview observation notes

“[He] seems to be an active manager. I was impressed by the way he spoke with such clarity and forbearance. I thought [the family member] would speak more but being one of five brothers seems to have taken the laidback approach and have left the actual day to day managing to the professional managers.” – June 2007, interview observation notes

Another interviewee compared and contrasted the experience of two business groups – pointing out the experience of outsiders and that professional managers contribute to

unlocking the market value of a company:

“Look at Ayala vs. Gokongwei: it has a lot to do with professional management teams rather than having family members. In Ayala – they quickly began to build professional management teams. From the very start they let professionals run the business. You can see it in their hires. My observation is they pay the hires for that. They have well-paid senior management. They pay for a professional management team.

“With the Gokongweis, the Chairman is now only opening up to pay professional managers. They have started (as they are traditional Chinese) in a more diversified manner. They are not afraid to pay top dollar. When you pay for top management, normally they (the top management) follow corporate governance to the letter. The traditional Chinese families, in rising markets, they need to go back to the market for funding. Or unlock the values of their companies. So they hire more executives from the outside.” –stockbroker

Reiteratively, professional managers in family-owned businesses make positive contributions to the value of the company in financial and reputational terms.

7.9.3 Professional Managers and Working Family Members

Issues arise when professional managers and family owners work with each other. For family members who intend to work in the business, grooming them for the responsibilities of the family-owned business and navigating them through their working relationship with non-family professional managers are crucial.

Where there are professional managers in place and in a society that values seniority, the working relationship between family members who are younger than the non-family professional managers, challenges this cultural norm. The power dynamic is biased in favour of ownership. The optimal interaction between family members and non-family professional managers must be based on mutual respect for one another as the following story illustrates:

“The Group Chairman is George S. Ty. Abacan is from the ranks who worked his way up. Abacan was the president and is now the chairman. The President is the son of Ty, called Arthur. Arthur went through the mill. Way bank in 1986 when I

first joined the bank, I was in Hong Kong and was using the Rolls Royce to come back from a meeting. I saw Arthur who was walking with an umbrella and I asked him where his car was and he said he had always walked this way. Except for Arthur, and his sister, the other board directors are not members of the family.” – non-family professional manager

In attracting professional managers to join a family-owned business, the rewards must be commensurate with the work performance:

“If you want to attract the best and brightest, there’s a modicum of standards that has to be met and they are meritocracy and transparency to the fore:

1. If I kill myself over 18 hour days, I have a reasonable chance to run the place.
2. Metrics evaluations are fair. Tangentially increase in good governance presupposes that internal systems are transparent and fair.” – private sector 1

Connected to this perception of meritocracy, where there is excessive nepotism within the business, the level of managerial competence suffers as hostility and resentment feeds non-family professional managers towards less competent working family members:

“The cons [of family run corporations] are you don’t always get the best men on top in terms of qualifications. There could be some conflict.” –private sector 2

As echoed by another interviewee:

“A lot of these companies say they’re professional but family members are still dominating. For example family members would need a better, nicer office than the non-family professionals. Managers are relegated to [less nicer offices.]” – private sector 3

Similarly, a family member wishing to work in a part of the business that may not play up to one’s strengths and competence can be an issue for professionals working alongside the member:

“The sister wants to be involved in [this division], not [the other division].” – private sector 4

In trying to reach an objective measurement of managerial performance one company

has applied the following system:

“We have a performance appraisal system called EVALEX, which was developed for us by a foreign consultant. It is a very comprehensive tool used to monitor management performance.” –private sector 5

In a family-owned business it is generally accepted that there would be family members who would be working in the company. To the extent that a family business has professionalised and has professional non-family managers on board, then the dynamics becomes that of balancing the needs of professional managers in being rewarded and continue to be attracted to work for the business, with the ambitions of the family to have continued involvement of members in the business.

7.10 Director Education and Training

Filipino executives in professionally run companies are well-versed with Western business practices. Some managers in blue-chip companies have been trained overseas or have had exposure abroad. Others completed their secondary and/or tertiary education usually in American educational institutions, while others have undertaken short courses in management and executive education in overseas business schools.

“Many people here are sons and grandsons of businessmen who started their companies 50 years ago. They are educated at NY, London and the best universities in the world. They have some idea of corporate governance. They run companies more in the traditional US corporate manner. They have straight departments. More and more companies are run that way and are graduates of US business schools.” –private sector 1

“Here in the financial business, a lot of leaders on boards studied abroad in the US – Harvard, Wharton, Stanford.” – private sector 2

“The Vice Chairman comes from the same family as well. The Vice Chairman studied at Ateneo and did his MBA at Harvard.” –private sector 3

“With Gokongwei, he sent his son Lance to Wharton.” –private sector 4

For one company, ongoing in-house training is considered part and parcel of a director’s duty. Topical issues of the business and the industry require directors to be

knowledgeable and kept up-to-date so their understanding and awareness of pressures facing the company are current and relevant:

“We encourage, or insist that at least twice a year the directors spend a good day in the business and understanding what the business is. So when they sit on the board meetings they understand the terminology.” – private sector 5

Ongoing executive director training is a valuable contribution to the continued success of a company. Not only does this improve the knowledge skills of the individual, but the lessons learnt make for well-prepared and well-qualified directors.

7.10.1 SMEs and Director Education

From one end of the business spectrum to the other, when I attended a MAP-sponsored corporate governance workshop, most participants came from the GOCCs and SME sector. The latter is heavily family-owned usually headed by a father and mother team. For most participants, this was their first exposure to concepts of corporate governance. I sat next to a second generation Filipina-Chinese woman whose father owns an import-export business. The following exchange took place with her:

“PARTICIPANT: I’m an AVP

ME: What’s an AVP? Associate Vice President?

PARTICIPANT: No. It stands for Any Vacant Position.”

For family-owned SMEs professionalisation remains a big issue. It is at this end where corporate governance is a concern because it is rarely practiced at all.

“The rural banking system is a pillar in the Philippine economy – but they are SMEs owned and operated by families in rural areas. They’re the ones who need a lot of help in corporate governance but they can’t afford [the training]. So some kind of grant and tax benefits [is needed] so that can further for those who can’t invest; and to start training these boards.” – private sector 1

In this regard, the School of Management at Ateneo de Manila University is working with SMEs to help them on governance, succession, professionalisation and mitigating family conflict though not on non-professional issues. The School provides a service as

an external family businesses consultant. The following box contains an account of the School's work with SMEs in the Philippines.

Text Box 10: Helping SMEs - An External Consultant's Account

"85% of the economy is made up of SMEs. We mainly work with rural banks in Northern Luzon. We don't advise them on rural bank legislation; rather we work with them on family business management. We concentrate on three issues: professionalising, family control, and succession planning.

"On corporate governance, it is not happening in this country, not the way that we have tried it. It is not happening in the SME set. MNCs have good corporate governance standards because their parent company has to comply with corporate governance requirements in the countries that they operate in. The efforts to reform have not been effective enough. It requires a personal initiative from owners and management of the company rather than regulation.

"We have established a family business centre here. Professionalising is a strong interest in family business. There are management issues related to family business issues. These are of huge interest to SMEs. However, the reforms are very slow because of the lack of desire on their part and the unwillingness to give up any degree of control. The governance issues are proof of that. Family control is not unique.

"In the School, we are moving towards finding solutions and working with SMEs who wish to run their business well. Can we make a difference at that level? Might it not be frustrating? We deal with SMEs wishing to professionalise and who have the desire to do that. We help family corporates and we have a family business development. We help establish the family council and promote the benefits of having one. We have workshops, briefings and we work directly with the business families. We have active consultations with them. We help them with family constitutions. With constitutions they are bound. They are written documents and all family members must sign and agree to them. With SMEs we follow on the family dynamics. Some need to speed up, adopt professionalism and figure out who should be on the board of directors and how decisions are made.

Emotional Baggage

"The problem for us is everything is personal. Everything is related. It's difficult to separate the personal from the professional. If you look at a family, there is a lot of emotional baggage. Culturally, we are more sensitive in our communication styles than Western families. Therefore the consulting activity is different compared to the Western environment. In Western countries, they deal with conflict, there is a level of openness, you can say things directly. Filipinos need to read between the lines. Everything is subject to the interpersonal, how it can be interpreted and misinterpreted. Values are different.

"I have advantages as an outsider. I'm not perceived as a threat to the extended family so that's what I bring to the table. The disadvantage is we don't work in families in crisis.

We are not here for a family therapy situation. That requires a different skill set altogether. If there's a deep conflict, there's a Center for Family Ministries⁸² on campus where troubled families can go and have therapy. We only work with healthy families. There is enough to deal with so we focus on them first.

"We don't deal with normal business where family dynamics are less important such as expanding into overseas markets or listing on the stock exchange. They are business strategy issues. Listing with the PSE is an investment banking decision so it's not necessarily an issue for us.

Succession

"What we deal with is professionalisation and succession. In mitigating family business conflict, we come up with an issue which presents conflict and strategise family business issues around that to deal with the conflict. Conflict can be avoided if you professionalise.

"On succession planning, so many people don't plan their succession. The problem is how to select the successor. This does not necessarily mean the eldest son just simply because he came first. That's why we advocate the Family Constitution. So they choose their successor this or that way, how to deal with in-laws, and non-family members, and rules by which they agree with and run.

"We have a very active practice here. We don't have to go out and seek clients. They come to us for help. We don't deal with families that use us for leverage such as some family members wanting to have their decisions supported or reinforced. The entire family must support us. The people who manipulate us as leverage are unethical or weak. If there is leverage, it is to provide leverage as an external consultant and the constructive use of leverage is to move in the best direction for the company."

For an outsider looking into the sometimes chaotic world of the Philippine economic landscape, it is worth recalling Lansberg and Perrow's observation on managers in developing economies:

"Too frequently, outside observers from more advanced companies tend to misread and criticise what in fact are adaptive and appropriate responses to complex and often difficult conditions, erroneously concluding that these businesses are poorly managed and organisationally immature. Since many of these families look to the more highly developed economies for ideas and validation, such negative opinions may even lead them to devalue their own sense of managerial competence." (1991: 129)

Highly skilled Filipino managers have evolved to meet the needs of their company in a

⁸² Center for Family Ministries (2009) <http://www.admu.edu.ph/cefam> accessed 19 September 2009

developing country environment - meeting pressures and working under conditions that surpass their developed country counterparts.

7.11 Other Decision-Making Bodies

While it was not the intention of this research to explore other decision making bodies outwith the company board, comments and responses from some interviewees mentioned the influence these bodies exercise on the board and the corporation. In a family business environment like the Philippines, these formal institutions help contribute to the future growth and existence of the business by formalising and drawing boundaries between the family, the business and the management.

As I did not anticipate the influence of these bodies, questions pertaining to their existence and functions were not in my interview guide. Nevertheless, it is difficult to deny the power they have and influence they exercise and so this section briefly mentions the existence of the following: the family council, family board and advisory board.

7.11.1 Family Council

In the Philippines, having a family council and family constitution becomes of great import when there are succession issues that need to be discussed and resolved. While these formal mechanisms may not mitigate all sorts of conflict, they are useful aids for business families and prevent family conflicts spilling over into the business and the public sphere:

“Many of our activities help family business transform into family corporations. We help them with the family constitution, family council, family members. The family constitution would deal with very complex issues involving family succession planning and compensation. There are 4 or 5 companies with intense family conflict because of the lack of a succession plan and a lack of clear policies which could play apart the wives. [The constitution] could be as simple as two pages long. It depends on the family business. A small family business wouldn't need an elaborate constitution.” – private sector 1

Lopez and Gonzalez in their study of Filipino business family succession cite the family council rules and practices of the Aboitiz Family as exemplary:

“There was the tradition of the annual family meeting. Eduardo Aboitiz initiated the informal gathering of families involved in the business. It was at these meetings where ‘disputes are resolved and the rites of bonding take place.’ In the years that the family met, certain rules were drawn up based on what the family had learned from its experience. These rules were regularly reviewed and widely accepted as a guide in the family’s involvement in the business. These rules evolved as prescribed formulas for the family. (2001: 146-147)

Other interviewees also mentioned the experience of the Aboitiz Family Council and their constitution as a guide for other business families:

“If you look at the family council for example, the Aboitizes, the board of directors in their companies have independent directors, the companies have professional managers. In the Aboitiz family council – the Chair of the Council is not the same as the Chair of the Board. It could be the mother. [The chair] is someone else not involved in the business.” –private sector 2

“The Aboitizes have adopted the family constitution. Any member of the family who is the head of the company must deserve it. These are principles that have been adopted. The family member in the business must earn [the head of the company] and be sustained. This is catching up, take a look at that –[the establishment of] family councils. [Others have] started writing their own family constitution. It’s in practice – having seen the success of the constitution, people have taken note of it. [They] take note of [the constitution], that’s great, and they do it likewise. The Aboitizes don’t distribute their constitution so there’s no template. The succeeding generations get in trouble with no rules. So the Aboitizes has given [other families the] light, [by providing] solution to the problems that we have.” –private sector 3

Other families known to have family councils include the Ayalas and Ortigas. The following comments are from a person who married into the Ortigas family:

“In the Ayalas, the family council is chaired by Don Jaime. The family council was before chaired by an aunt, Mercedes McMicking. All sorts of organisation including smaller groups can run family councils. In the [Ortigas] family council, we don’t meet as often as the family board structure. Normally it is a practice. My

wife's family is in real estate, we meet as siblings with parents, and spouses and children. We meet as 30 people and talk about business. Some assigned members talk. For more complex family structures there is the cousin consortium. [In this country], we have family businesses who have evolved to family run where distinct family issues are kept away from the family business.” – Ortigas family member

However, these examples may be the exception, rather than the norm:

“If there's such a thing as a family constitution, that'd be rare. A very rare exception. Why is that? I doubt if they'd follow that. Filipinos don't sign contracts in families. I haven't seen anyone do that.” – academic

One of the biggest challenges for family councils is when formal mechanisms, such as the constitution, do not reflect the situation of the family and the business. As advised by Ward, agreements should respond and be altered according to the changing circumstances of the family – and the business (Ward 2008b: 114-116)

7.11.2 Family Board

In contrast to the family council where several generations of the same family may gather and discuss family issues that are intertwined with business issues, the family board is a parallel decision-making body to the company board. Only one company explicitly mentioned the existence of the family board and this is the ultimate decision making body for the family enterprise. The company in question fits the description of a family-operator (that is, there is intense involvement with companies as stated by Davis 2008: 144) type of business although it is undergoing transition towards greater professionalisation and generational succession. Not surprisingly, owner/control-related issues are made explicit in the family board. The company board, in effect, reinforces the decisions made in the family board:

“SM has a family board. They would formally hold meetings every two weeks and there has to be a quorum. The meetings are minuted. Significant decisions are made on the family board level. Mutual decisions are made at the family board level and then on the board of directors. The family board is concerned with

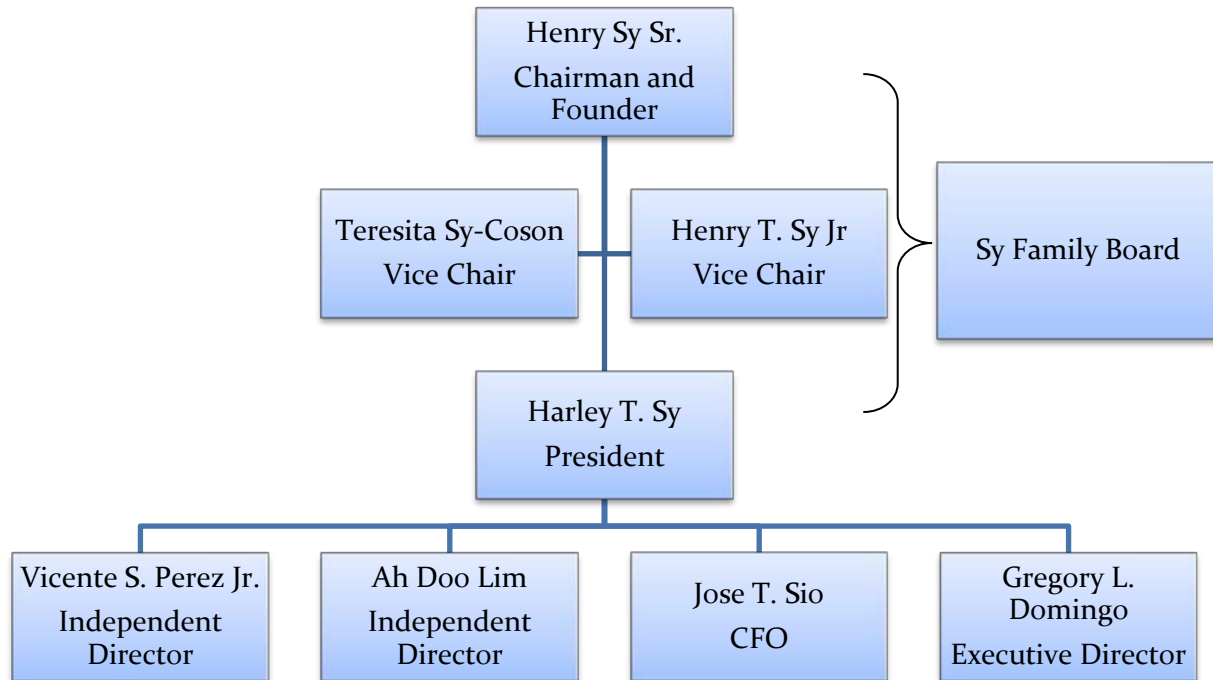
subsidiary related decisions. Henry Sy has six children and all of them are managing and running in the business:

“The eldest daughter, Tess, has oversight function of head core businesses: retail and banking. The second daughter is into hotels and SM Prime. The eldest son is Henry Sy Junior and is in Sedona Property. The second eldest is Hans and he is into SM Prime. The third son Herbert is in Supermarkets. The fourth son Harley is the President of SM Investments and is directly involved in retail. While Tess won’t comment on it, it’s an open secret that she is the successor. She was heavily involved in building the organisation. She was mainly responsible for merging BDO and Equitable PCI banks. She has the vision and carried this out with a lot of passion. One of the daughter-in-laws is involved with SM Foundation, the wife of Harley. She is much involved with that.

“The quorum for the family board is four out of six siblings. It is chaired by the eldest (e.g. Mr. Sy or Henry Jr.) or the most senior. There is consensus building through this board. The office of the family board is in Makati so most of the time the family board meetings are held there. The family board is a very small, tight community. There are two or three non-family members. Presently, they allow more members to come in and sit on the family board depending on the topic. In this, the group handles mergers and acquisitions, and minutes are taken down. The family board is more of a setting/agreeing direction of the policies of the group. There is more management. So the left hand knows what the right hand is doing. That is, coordinate all the different business activities of the group, and they are discussed at the family board level.” – SM

The following figure is of the holding company SM Investments Corporation’s board structure in 2009 and family board.

Figure 38: SM Investment Corporation (2009) Board of Directors and Family Board



7.11.3 Advisory Board

Lastly, there also exists the advisory board as another influential body. The advisory board “primarily provides advice to a firm’s top managers” and is comprised of highly influential people that is held in great esteem by the firm (Blumentritt 2006: 67; see also Tapies & Ward 2008). Though some conglomerates utilise their advisory boards for external advice and strategic planning purposes, only one interviewee explicitly mentioned their advisory board and their importance to the group. Echoing what an advisory board should contain, this group’s advisory board is comprised of well-connected elites:

“We also have a board of advisers: they attend [a board] meeting on a rotation basis We have Dr. Placido Mapa who was previously an executive director of the World Bank, Washington SyCip SGV Founder, Attorney Hizon, Undersecretary of Finance, a former press secretary of [President] Estrada...Not only is the board strong but we have a strong board of advisers. Our boardroom only has 24 seats so it gets crowded and there is no space for everyone.” – Metrobank

The following figure is an abridged version of Ward's 'Governing the Enterprise Family' (2008:104) and the structure sets out the different bodies available to large, complex family-owned businesses in the Philippines. This perspective places into context the company board is but one of many operating branches in a business family (under Holding Company). Future research could explore the influences and relationships of these various bodies, how they impact the company board, and where they fit in the study of corporate governance of family-owned businesses.

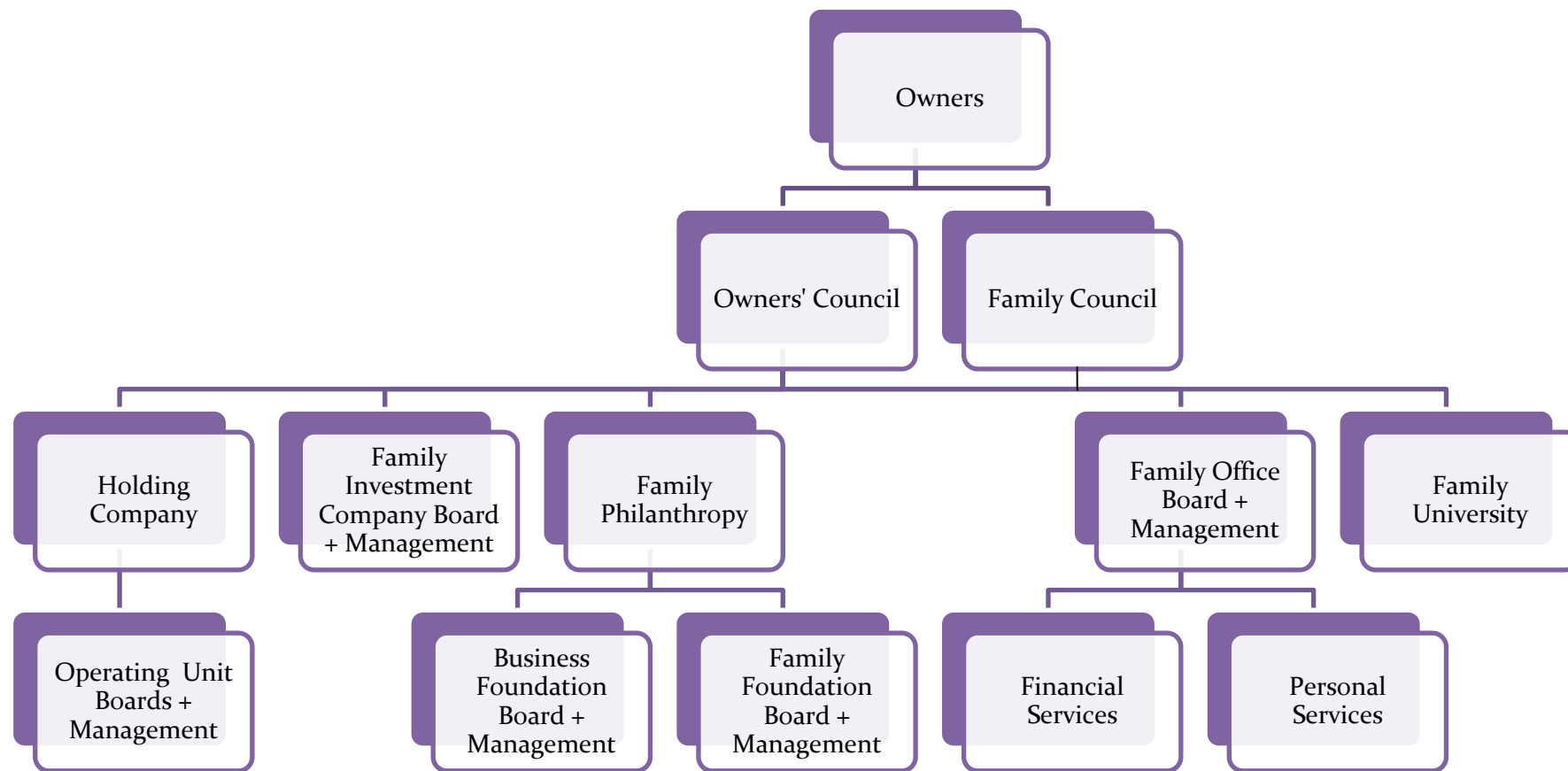


Figure 39: Abridged Version of Ward's Governing the Enterprise Family (2008b:104)

7.12 Closing Remarks

In closing this chapter, it is worth reprinting the sage words from a group of family business academics. Their perspective on the particular needs and demands of those involved in a family-owned corporation show the different dynamism extant in these organisations:

“The role of chairman of the board is different when the company was founded by your father and when your mother and siblings sit around the table at board meetings, just as they sat around the dinner table. The job of a CEO is different when the vice president in the next office is also a younger sister. The role of partner is different when the other partner is a spouse or a child.

“Companies owned and managed by families are a special organisational form whose ‘specialness’ has both positive and negative consequences. Family businesses draw special strength from the shared history, identity, and common language of families.

“When key managers are relatives, their traditions, values and priorities spring from a common source. Verbal and nonverbal communication can be greatly speeded up in families. Most important, commitment, even to the point of self-sacrifice, can be asked for in the name of the general family welfare.” (Gersick et al 1999: 2-4)

Family businesses, their owners and their values will continue to important determinants of corporate governance in the Philippines.

CHAPTER 8: GOVERNMENT FINANCIAL INSTITUTIONS

This chapter looks at the impact of corporate governance on three government financial institutions: the Development Bank of the Philippines (DBP), the Government Service and Insurance System (GSIS) and the Social Security System (SSS). The DBP is a wholly-owned government bank while the GSIS and SSS are the pension/superannuation funds for public and private sector employees respectively. In a country where financing and sources of funding are critical, the three government financial institutions covered in this chapter have at various times been politicised and their organisational functioning compromised.

Corporate governance reforms must be seen in the context of their operating environment. This chapter provides a brief background on presidential appointments and what role they play in affecting the operationalisation of corporate governance reforms in government institutions. Being government institutions, all three organisations have experienced the delicate balancing act of pursuing organisational objectives concurrently with political wishes – more often than not, at the expense of the former to appease the latter.

A brief history of the DBP, its turbulent time under Marcos, its consequent rehabilitation under Estanislao and corporate governance reforms in the DBP are examined. Following on from this, the organisational mandate and structure of GSIS and SSS are discussed and how this shapes their corporate governance function as the main local institutional investors in the country. One of the ongoing debates in Western corporate governance is the exercise of influence and activism by institutional investors. In this context, the institutional investor influence of GSIS and SSS are examined. The latter half of this chapter looks at the role of GSIS and SSS, their charters, the legislated investment limitations in their charters and their investments. The actions of the pension funds in an episode involving former President Estrada and a bank merger provide an insight into how institutional investor activism is exercised and conducted in a non-Anglo American corporate governance environment and a weak bureaucratic state.

Finally, this chapter discusses the challenges facing public sector organisations and their boards due to the nature of the presidential appointment system.

8.1 Development Bank of the Philippines

The Development Bank of the Philippines (DBP) is one of three remaining state-owned banks in the country. The other two are the rural bank, Landbank of the Philippines and the Islamic bank, Al-Amanah Islamic Bank.⁸³ Originally known as the Rehabilitation Finance Corporation (RFC), the bank was initially established in 1947 to provide financing to rebuild and reconstruct the country after the devastating impact of World War Two⁸⁴. Initial funding came from the United States and the World Bank. The USA felt obliged to contribute substantial reparations to the country due to wartime damages as a result of being the main American colony in the Pacific. A decade after its establishment and the completion of reconstruction efforts, the RFC was renamed the DBP with a mandate to support commercial and industrial projects in the country. Annually, 50% of the bank's net income is given to the government in the form of dividends. The DBP is a bank and a development institution. Currently, there are no plans to privatise the bank which is in a relatively strong fiscal position compared to the other two government-owned banks.

8.1.1 Descent into Hell: DBP under Marcos

The experience of DBP under the Marcos dictatorship echoes common themes in similarly well-placed government organisations. As a financing institution, the DBP's funds were diverted to serve the wishes of the dictator in so called 'behest loans' because the loans are made at the behest of the incumbent rather than in fulfilling the organisation's purpose. A snapshot of the DBP under the Marcos years is set out in the next table. Note the increased deterioration and lack of solvency of the bank in the closing years of the Marcos dictatorship:

⁸³ The Landbank of the Philippines is oriented towards financing rural and agricultural oriented projects; and Al-Amanah Islamic Bank is oriented towards operating and financing under the precepts of Islamic banking. Al-Amanah was established under Marcos with a "mandate to promote and accelerate the socioeconomic development of the autonomous region of Muslim Mindanao by providing banking, finance and investment operations using the concept of Islamic banking and is the only bank authorised by the government to conduct Islamic banking in the Philippines." (Remo 2007e). In May 2007, there was an unsuccessful attempt to privatise 90% of Al-Amanah Islamic Bank. This was the fourth such attempt to privatise the bank. The Economist suggested "The lack of bidders was probably due to the bank's incurred losses" especially with a portfolio containing substantial non-performing assets. The formerly government-owned Philippine National Bank (PNB) was privatised and its controlling owner is Lucio Tan.

⁸⁴ For a substantial history of the DBP, see DBP (1997) Fifty Years of DBP: A Developing History of the Philippines, Makati: DBP.

Table 30: Selected Chronology from DBP (1997) Fifty Years of the DBP

1969: A cash crunch emerges. There is heavy pressure on DBP's cash resources, as the emphasis on large-scale projects requires correspondingly large amounts of cash. To increase funds, DBP taps SSS and GSIS, and uses the overdraft and discounting lines with PNB.

1970: DBP's funding problems come to a head. The devaluation of the peso catches the DBP at a vulnerable time when its foreign exchange liabilities are at a peak...These [foreign currency] debts come due in 1980, and with its clients on the brink of defaulting on their debts, the DBP has no choice but to honour all foreign obligations. Thus DBP is forced to cut down on domestic lending operations and suspend almost all new guarantees.

1981: The economy is faced by a banking crisis when businessman Dewey Dee flees the country with USD100M in unpaid debts. This creates a cash crunch for both banks and industries. Banks refuse to roll over short-term debt. Among the hardest hit are big industrial and mining corporations. To avert their impending bankruptcy, Marcos orders 5 GOCCs – including DBP and PNB – to bail out the distressed corporations. These 'behest loans' divert billions in badly-needed capital from productive investment...DBP serves as one of the primary conduits of funds in the government's efforts to bail out many troubled corporations. Billions of pesos are utilised for this purpose. All other lending takes a back seat.

1982: DBP suspends all lending activities in the second half of the year, as almost all its capital for lending has gone into bailouts of troubled corporations.

1983: DBP continues to be strapped for funds; acceptance of new loan applications remains suspended and behest loans continue to take the majority of the bank's lending capital.

1984: Many of DBP's projects fail to make payments; the acceptance of new loan applications remains suspended, as behest loans continue to take up most of the available capital.

1985: DBP continues to experience difficulties in its operations. Many projects begin to default on their payments...Lending, the most vital operation of the bank, is at a virtual standstill. The bank no longer grants equity investments or guarantees.

1986: DBP is in a dismal state. 90% of its portfolio is comprised of non-performing assets (NPAs) and it is weighed down by a large and unwieldy organisational culture. Jesus P. Estanislao is appointed Chairman of DBP. He develops an extensive Rehabilitation Plan which calls for the transfer of NPAs to the national government and the downsizing of the organisation. A new corporate culture of excellence anchored on integrity and competence, teamwork and professionalism was introduced. Chairman Estanislao leads the drive for DBP's financial and spiritual renewal. (DBP 1997: 23, 29, 30-32)

Like many organisations in both public and private sectors, the legacy of the Marcos years remains imprinted on the DBP. For those who lived through that era, the experience of being in a highly politicised government institution to serve the wishes of one person or one family remains a strong legacy issue. The dictatorship has left deep psychological wounds that are slowly healing. Every incoming presidential administration is treated with the suspicion of what would they want to do - whose

interests would they force the organisation to serve? Was the dictatorship an historical aberration or is it waiting to happen again? Can this cycle ever break?

Organisationally, the culture of the DBP under Marcos was badly afflicted. During martial law, the DBP was used as a milking cow for Marcos. As a financial institution, at one point it was mooted that the DBP would merge with then government-owned bank PNB. With a surfeit of cows available for milking, merging the two would at least consolidate one's efforts.

For DBP employees, leadership by example saw bank officers dawdle as their superiors loitered. The DBP's reputation in the private sector was held in low-esteem. Eyewitness accounts abound of many drinking sessions between supervisors and their staff in the middle of the working day. One wondered whether it would be best to approach the bank after lunchtime if being intoxicated was a contributing factor to a loan's approval. According to Hutchcroft, "the DBP was said to have 'the easiest touch in town.' People with good political connections could get loans with only a few questions asked." (1998: 186).

Compounding this impression was the internal procedures of the bank. If someone wanted to borrow P50M to fund a project, half of it would have already gone to paying off the DBP officers. The standard was a 2% cut for the loans officer, and upwards to the board level (Dohner & Intal Jr. 1989: 500). As one interviewee observed:

"The moment a bank gets a bad reputation, they are tainted. After all, a bank deals with the business of trust. The DBP balances its development mandate and earning money with the government projects it funds." – public sector

Thus, the reputation of the DBP at the end of Marcos' downfall was in tatters. Financially it was broke. Spiritually it attracted those motivated and unfazed to commit corruption and fraud. Organisationally, it was dysfunctional. It was no longer fulfilling its role as a bank. At the same time, the DBP was still widely considered as too important to be dissolved. It was with a certain amount of irony that the bank which was originally established to rehabilitate the country was in need of rehabilitation itself. The road to rehabilitate the bank after the downfall of Marcos was a main challenge for the incoming Aquino administration. The rehabilitation was tasked to one man whose reputation for integrity carries on to this day.

8.1.2 Rehabilitation under Estanislao

In recent times, Dr. Jesus P. Estanislao is known as the main champion of corporate governance in the Philippines. (see also Chapter 4) He has enormous goodwill in both the public and private sectors. He is held in high esteem and his influence is carried widely. He built this reputation and solidified it when he turned around and rehabilitated Marcos's milking cow. He transformed an organisation riddled with corruption into a model of efficiency with clear governance functions. Estanislao rose to the enormity of this challenge and his success in reorganising the DBP cannot be overestimated.

The law for the DBP was amended after Marcos' departure. Addressing the legacy issues meant introducing new blood. Estanislao downsized a bulky organisation and hired people from the private sector. The concept of risk management was re-introduced after remaining dormant during those dark years. A risk management manual consolidated all banking guidelines and circulars and this addressed the window dressing of past loans and refinancing of past dues.

At the heart of an organisation is the company's corporate culture. During my interview at the DBP, my interviewee and I were interrupted at 3pm by prayers that were broadcasted throughout the building. My interviewee glanced at me and said: "That's Estanislao's legacy." The imprint of Estanislao can be seen in the DBP foyer and the daily reminders of prayers: the Angelus at 12pm and the aforementioned 3pm prayer. Furthermore, at the start of the working week, DBP employees sing the national anthem and recite the DBP credo (see table below).

Table 31: The DBP Family Credo (DBP 2009a)

I belong to the DBP Family
A family that puts country above self
A family committed to a progressive Filipino society
Where everyone is self-reliant and socially responsible
Where opportunity for enhancement of personal dignity is open to all.
I believe that the mission of DBP
Is to make the Filipino productive and competitive
So that the people's basic needs are adequately met
And so the nation's aspirations can be fulfilled
By the constant struggle of our people to rise above themselves.

I share the hope DBP places in entrepreneurs
Who seek to link industries, sectors, and regions
To deepen and widen their interdependence
Who seize the opportunities created by change
And work as partners with those taking the lead in development.

I dedicate myself to DBP as an institution
Whose interest must be placed above my own
Where commitment to service is before personal ambition
Where the trademarks are: integrity and competence, teamwork and professionalism.

With the help of God almighty
I pledge my whole heart and mind
To the pursuit of excellence
Because I belong to the DBP Family
Because I am a Filipino.

The spiritual and organisational healing instigated by Estanislao is remembered fondly:

“Jesus Estanislao came in after 1986 and rehabilitated DBP. Estanislao is a model of corporate governance. He came in as Chairman and turned around DBP. Previously we had 80% delinquent loans. The DBP employees dealt in graft and corruption. By 1989, three years after the government gave the organisation P17.5B to recapitalise the bank after Marcos, we were able to return that obligation. Internally we have grown to P35B. That debt to the government was repaid within 3 years.

“The corporate culture here has changed. Employees were recruited from other private banks and a new board of directors came in. Everything has been professionalised. Estanislao was here [until 1989]. Those were the glory days as we were known as the best-managed bank. After Estanislao left, and when the new Chairman [Roberto F. de Ocampo] came in, the after effects were felt in the bank’s performance and this was due to Estanislao.

“Estanislao’s legacy to the bank is the DBP credo. Every Monday is part of his legacy. Every now and then, Estanislao comes here and is applauded by employees. Of course there are younger employees now – those who don’t remember what the DBP was like before and after Marcos.” – DBP

In 2007, the DBP has 3,000 employees with 77 branches around the country. The bank

has wholesale and retail lending arms. For the retail arm, issues over money laundering and identity theft are growing. The wholesale lending arm deals with accredited commercial clients such as the main commercial banks in the country. The bank funds business and commercial projects.

8.1.3 Introducing Corporate Governance in the DBP

As a bank, the DBP is supervised by the banking regulator, the BSP. The main corporate governance reforms in the country were firstly directed at banks and so the DBP was initially affected by the introduction of Basel II reforms. Like other private sector firms, hypotheses 1 and 2 are supported, and given DBP's ownership structure with the owner being government and therefore the 'principal', hypothesis 3 is not supported. This last hypothesis parallels private sector firms with active and controlling owners though as a government institution, it is largely due to politicisation – which arguably is a manifestation of controlling principal-agent relationships – that exposes why hypothesis 3 is not supported.

H1: Post-1997 corporate governance policies in the Philippines will exhibit similar ideas contained in Western principles of corporate governance

H2: Post-1997 corporate governance practices in the Philippines institutions and firms will not diverge from indigenous customs.

H3: Philippine firms that have adopted Anglo-American corporate governance practices are more likely to exhibit well-defined principal-agent relationships.

The formal corporate governance procedure in the DBP consists of the following elements (DBP 2009b):

1. Corporate Governance Committee: This board committee was established in response to regulatory reforms. It meets monthly and the committee has a charter which addresses the duties and responsibilities of directors. The committee also oversees how corporate governance principles are implemented.
2. Corporate Governance Manual: A formal document that looks at how corporate governance is implemented within the bank. It contains information on compliance requirements, duties of directors and committee structure.
3. Self-Assessment and Director Peer Assessment System: This is an internal procedure which evaluates and assesses the abilities of bank directors. Each director is required to assess one another. Directors are candid about each other's

performance and this peer assessment allowed an evaluation of a director's weak and strong areas. There were six components in the peer assessment and weighted by percentage:

- a. Competence as a director (15%)
 - b. Independence (15%)
 - c. Preparedness as a director (20%)
 - d. Practice as a director (20%)
 - e. Committee activity (15%)
 - f. [Contribution to the] Development process of the corporate enterprise (15%)
4. Code of Ethics: This code provides guidance on behaviour expected of DBP directors and employees.

These policies cement corporate governance's introduction in the bank.

8.1.4 DBP Board Committees

The operationalisation of corporate governance in the bank can also be seen in the board committee structure and membership of the bank as outlined in Tables 32 and 33 on DBP's Board and Non-Board Committees (see next two pages).

There are 8 board committees. 5 of the committees were established after the main banking corporate governance (or Basel II) reforms (see Table 33). Management by board committee is seen as the most visible aspect of corporate governance reform in the banking system as these committees doubled the pre-2000 structure:

“The introduction of these committees was the big change in the banking system and we have had to adapt to it.” – DBP interviewee

The Executive, Trust and Human Resources Committees have been present since the Marcos years. After the introduction of corporate governance reforms, the Audit and Compliance Committees were merged into one committee. The Audit Committee existed before the Basel II reforms while the Compliance Committee was established in 2000. The Trust Committee deals with the banking services provided by DBP which manages trust funds governed by the country's law on trust for retirees, private, public companies and individuals. The Development Advocacy Committee is one of the more

recently established committees. This committee supports the specific advocacies of the bank such as micro-financing and the forestry fund. Advocacies of the bank form part of the organisation's development mandate. Projects under the oversight of this committee are not expected to generate significant financial profits; however, they are expected to make significant environmental and societal impact and contribution for the country.

Out of all the committees, the Risk Management Committee has the most ex-officio members reflecting the pre-occupation of the bank with the efficacy and standards of its internal audit and control, and associated risk management issues.

These board committees have formalised the concept of risk management, good corporate governance, transparency, disclosure and financial reporting within the bank.

There are also two notable non-board committees as set out below:

Table 32: DBP Chart of Non-Board Committees (as at January 24th 2007)

Non-Board Committees		
	Provident Fund	Credit (CRECOM)
Established	Prior to 1986	After 1986
Membership	Chair: Oliveros	Ex-Officio Members: Dichoso; Durano

The Provident Fund Committee was established for the financial security of DBP employees and has existed since the Marcos years. From every DBP employee's monthly salary, a contribution is made towards the provident fund. The fund provides earnings and profits; rewards are shared. The bank makes a co-contribution of 5P for every 1P provide into the fund.

The Credit Committee or CRECOM was established immediately after Marcos' downfall. This committee came into existence immediately after the introduction of a risk management manual to the bank. The bank's risk manual was the main policy instrument used to reform and rehabilitate the organisation. The committee evaluates loans above P15M. The approval of this committee is required before the loan is granted. The assessment is made on the viability and recovery of the loan. If further discussion is required, then assessment of the project is escalated to the board level. The head of CRECOM is also an ex-officio member of the board committee on Committal Risk Management.

Table 33: DBP Board Committees and Members (as at January 24th, 2007)

Board Committees ⁸⁵								
	Executive*	Audit and Compliance (ACC) **	Risk Management	Trust**	Human Resources**	Governance**	Development Advocacy	Small-Medium Enterprises
Year Established	Prior to 1986	Merged after Basel II (2001 / 2002)	After Basel II (2001/2002)	Prior to 1986	Prior to 1986	After Basel II (2001/2002)	2006	2006
Membership								
Chair	Sto. Tomas	Dichoso	Magno	Romero	Sto. Tomas	Durano	Teves	Pangilinan
Vice Chair	David	Oliveros	Pangilinan	David	Magno	Dichoso	Pangilinan	Teves
Member/s	Oliveros Teves Romero	Sto. Tomas	Romero	Teves Durano Head, TS	Oliveros	Sto. Tomas	Oliveros	Durano
Ex-officio members								
	All other directors; COO; CLC	President; all other directors; COO; CLC or rep	Chair; President; all other directors; COO; ACC Chair; CRECOM Chair; Head of Internal Audit; Head of Risk Management Unit; Treasury Head; CLC or rep	Chair; all other directors; COO; CFO; Treasury Head	President; all other directors; COO	President; all other directors; COO	Chair; President; all other directors; COO	Chair; President; all other directors; COO; MFC Head; SME Development Program Rep

⁸⁵ * Quorum: all members of the executive committee must be present to muster a quorum

** Quorum: majority of all members

Notes on acronyms: CLC: Corporate Legal Counsel; COO: Chief Operations Officer; CRECOM: Credit Committee

In recognition of the DBP's stride in implementing corporate governance within the organisation, the bank received an award from the Association of the Development Financial Institutions in the Asia Pacific (ADFIAP) for having the best corporate governance program for a development bank in the region. (ADFIAP 2007)

In contrast to its rehabilitation, operationalising corporate governance within the bank has not been traumatic. There is stronger sense of trust and confidence within the bank and its employees:

"I can give my responsibilities to my staff office members and leave them for a week and things won't collapse." – DBP interviewee

Corporate governance is welcomed and not at all dissuaded at the DBP - if at least to prevent another turbulent event in the organisation:

"We don't want another rehabilitation program [such as what happened in 1986] at DBP. This will be our legacy." – DBP interviewee

Introducing corporate governance reforms is seen as essential in enhancing the bank's growth, development and reputation. The reforms are part of the natural evolutionary process for the financial institution.

8.2 Government Service Insurance System

The Government Service Insurance System (GSIS) was created in 1936 during the American colonial period with the passage of the Commonwealth Act 186 to "look after the needs of the nation's public servants when they could no longer look after themselves or their families." ⁸⁶(World Bank 1995: 28)

GSIS' is one of the oldest social security programs in the region still in existence today with a mandate covering a variety of social security benefits:

"...to provide and administer the following social security benefits for all employees of the Philippine government: compulsory life insurance, optional life insurance, retirement benefits, disability benefits for work-related contingencies and death benefits."(GSIS 2009)

⁸⁶ For more information on GSIS' history and legislative changes that expanded the original functions of GSIS, see World Bank (1995:28).

As the overarching organisation dealing with government employee pension, membership is around “1.42M consisting of all employees of government regardless of status except for uniformed members of the military, police, jail management and fire protection.” (Palmiery 2002: 4) Administering the system are around 3000 GSIS employees with the majority located in a magnificent building on reclaimed land overlooking Manila Bay.

Recently, reforms in the administration of GSIS have included changes to the premium based policy and computerisation of member records promoting transparency and disclosure:

“The earth-shaking policy has been the premium-based policy. It was previously taken for granted that those who contributed [was] based on other agencies’ information. For example, the number of years you worked in a government agency, [it was] taken for granted that you also contributed to your pension calculated by the number of years you worked in the agency. But now, the rationale is, what you put in is what you get out. There has to be creditable years of service. Upon its development there were lots of protests. The new databases⁸⁷ cleaned the premiums paid on the agency; not the premium based on services.” – GSIS interviewee

The GSIS the government owned pension fund of the country, and is therefore one of the largest institutional investors in the country. Where the SEC supervises publicly listed corporations, GSIS (with SSS) are indirectly supervised by the Department of Finance. Executive orders on corporate governance are administered by the Department allowing both funds to set up their corporate governance procedures.

8.2.1 Corporate Governance and Financial Reporting

Similarly to DBP, the introduction of corporate governance within GSIS is most visible in the establishment of new board committees. In 2006, GSIS formed “specific committees to assist the Board of Trustees in developing corporate governance principles, as well as in policy formulation and in the exercise of oversight responsibilities.” (GSIS 2007:21) The introduction of these new committees has rendered a sagacious board culture:

⁸⁷ See BizNewsAsia (2006)

“[The following] committees were created to help it manage and function GSIS:

- * corporate governance committee
- * risk committee
- * audit committee
- * legal oversight committee to the board of trustees

“These committees are oversight functions. These functions carry much weight. Committee members are members of the board. These reforms have made the board more careful, more prudent, and more circumspect in its actions.” – GSIS

The Corporate Governance Committee oversaw the following activities in 2007:

- “corporate governance and strategic guidance (over new technologies)
 - capacity-building activities (including seminars on best practices in corporate governance)
 - performance evaluation (awards and recognition and performance appraisal of employees)
 - compensation (“under which the Committee reviewed and recommended a policy on payment of benefits withheld from employees previously charged with administrative offenses but were subsequently exonerated.”)
 - stakeholder relations and social responsibility (such as support for hospitals)
 - other responsibilities (reviewing of joint ventures with real estate interests)”
- (GSIS Annual Report 2007: 21)

In its 2007 financial statements, GSIS reported “consolidated total assets (unaudited) amounted to P441.44B...the marked improvement was attributed to the growth in the Social Insurance Fund (SIF) which posted P410.08B. The SIF is the source of social insurance benefits of the more than 1.5M GSIS members, and thus makes up bulk of [GSIS] consolidated assets.” (GSIS Annual Report 2007: 34). The Social Insurance Fund is also the source of investible assets for GSIS (see Section on Investment Portfolio and Strategy). Thus It is difficult to fathom why GSIS’ financial statements remain unaudited (see pp.36 and 37 of the 2007 GSIS Annual Report). In this regard, good corporate governance practice of transparent, accountable reporting has not yet filtered through in GSIS’ financial statements.

8.2.2 Views of GSIS

The wealth held and generated at the GSIS fund comes with a heavy weight of responsibility. As the sole pension fund for government employees, there is wariness as to whether the funds are being used for their intended purposes. According to one interviewee:

“The monopoly powers of GSIS are basically its recipe for inefficiency. Government employees complain of unacquired loans. The budgetary constraints are institutionalised. They have the government employees’ money. There are sources of possible corruption – both soft and hard corruption. It happens in GOCCs. Whose money is it? Who’s making the decisions? How do they manage it from [political] interference to [one without]? [GSIS] doesn’t have full control. All of government want some contribution to a particular fund. They change rules of what public servants can do to any amount they [politicians] want.”- former public servant

Amongst other interviewees there remains the perception of GSIS as a heavily politicised organisation where investment and funding decisions are not done in an impartial way.

8.2.3 GSIS’ President and General Manager (PGM), Winston Garcia

The President and General Manager (PGM) of GSIS play a pivotal role in the investment decisions of the organisation. The PGM “exerts a strong influence on the direction and investment strategies of the portfolio” and the portfolio choices in both GSIS and SSS funds reflect “the preferences of the heads of the institution as influenced by their levels of experience, exposure and orientation.” (Palmiery 2002: 15)

Presumably investments in government securities signal a more conservative approach in the financing strategy while investments in equities mean the organisation is headed towards a more active and risk-taking culture. As with any political appointee, the PGM must balance the demands between the political objectives, and organisational needs:

“At present, all members of the policy making bodies of the pension funds are political appointees. Moreover, the CEO serves at the pleasure of the appointing authority. The situation makes the management vulnerable to political influences.” (Palmiery 2002: 19)

At the time of data collection, the PGM of GSIS, Winston Garcia is widely known for being a strong and close ally of then President Macapagal-Arroyo. His political affiliation is both a strength and weakness for the organisation. The advantage of his political connection is he has the political mandate and support to implement strategic reforms for GSIS. This can be seen in the organisation's strategy to go global with their investments (see section on GSIS' search for a global fund manager):

“We are gearing up for our global investments. We have a headstrong PGM: he serves at the pleasure of the president. It is expected he would still be here for the next 3 years. We expect a lot of people to comment on reforms especially with our global investments.” – GSIS

However, the weakness is his activities have come under scrutiny especially from political opponents of then President Macapagal-Arroyo. Being in the public eye and head of the government employees' fund, investments of any kind are scrutinised. Garcia's purchase of paintings by Juan Luna and Fernando Amorsolo, two of the Philippines' greatest painters, caused some controversy due to the value paid and type of investment asset (Burgonio 2008, GSIS 2008). The paintings are now part of the art collection of the GSIS museum. (GSIS 2009b)

Garcia's father, Senator Pablo Garcia is a political representative from Cebu. A dispute involved between Senator Garcia and House Speaker Jose de Venecia Jr. spilled out into the public arena with suggestions from de Venecia that Senator Garcia was receiving funds for his election campaigns from GSIS because of his son's position (Gagni 2007). GSIS' Garcia challenged this assertion by filing a libel suit against a de Venecia supporter, Manila representative Bienvenido Abante. Abante had sought to open the books of accounts of GSIS (Esguerra 2007).

Thus the PGM of GSIS requires a set of diplomatic and political skills that go beyond the organisational, professional and operational requirements of the position. The leader of a pension fund in the country requires having the innate ability to meet the needs of different stakeholders and navigate the unpredictable waters of Philippine politics.

8.3 Social Security System

The Social Security System (SSS) was created nearly two decades after GSIS in the post-

war environment of the Philippines with the passing of the Republic Act 1162 in 1954. Whereas the GSIS serves the needs of public sector employees, the SSS was established to address the needs of people employed in the private sector.⁸⁸ Over the decades, the SSS scheme was expanded to include: “the self-employed (1990), farmers and fishermen (1992), domestic helpers, overseas contract workers (or OFWs) and workers in the informal sector with monthly income of less than P1000 per month.”⁸⁹ (Palmieri 2002: 4)

Administering the fund are around 4,000 employees and another 1,500 contractors mostly based in Quezon City. Due to some organisational rightsizing of the SSS in the past decade, there is a high amount of contractual workers (clerks, encoders and frontline people). Eventually the intention is to make the contracted workers part of the regular workforce but this depends on the limits of the SSS budget.

Organisationally, SSS has resource issues regarding staff numbers:

“SSS has 26M members, GSIS has 1.5 members but we have the same number of employees to look after different number of members.” – SSS

The quiet rivalry between the two pension funds is also well-known especially when it comes to investments and member contributions:

“[In 2007] our asset base is P235M, the GSIS is P400B. That wasn’t always the case. Until 2000 SSS was ahead of GSIS but eventually GSIS took us over. There has always been a silent rivalry between GSIS and SSS. There was a competition on projects. We were leading them on investments in 1997, but only in 2005 that we’ve fallen behind them. The functionalities are different. There’s a controlled membership base at GSIS. 1.5M vs. 26M. How can you compete?

We have to work more on volumes, a catch up game as far as the volume is concerned. There’s flexibility in how they are concerned – they have higher

⁸⁸ As outlined in Section 2 of the SSS charter: “It is the policy of the State to establish, develop, promote and perfect a sound and viable tax-exempt social security system suitable to the needs of the people throughout the Philippines which shall promote social justice and provide meaningful protection to members and their beneficiaries against the hazards of disability; sickness, maternity, old-age, death and other contingencies resulting in loss of income or financial burden. Towards this end, the State shall endeavour to extend social security protection to workers and their beneficiaries.”

⁸⁹ Section 9 of the SSS charter looks at coverage: “Coverage in the SSS shall be compulsory upon all employees not over 60 years of age and their employers: Provided, that in the case of domestic helpers, their monthly income shall not be less than P1000 a month.”

contributions...The reputation of GSIS is getting better. There's also a salary cap of P15,000/month as contribution from members. 10.4% contribution is applied only to [those with] P15,000. GSIS has no ceiling as far as salary is concerned. There's 21%, 9% from 12% for a government agency. [Their contributions] are entirely different". – SSS

With more people employed in the private sector, the SSS is a much larger scheme than GSIS. In 2006, a World Bank study ranked the SSS scheme as the most important and biggest in the country (Ghosh 2006: 130). In 2002, SSS had 19M registered members although only 7M are actively paying. In 2006, the coverage remained stable with the SSS covering 74% of the private sector but only a 1/3 are active contributors. (2006: 132) In terms of the nominal contribution rate, the employee rate is 3.3% while the employer rate is 6.1%. The contribution from the scheme as percentage of GDP is only 0.7%. (2006: 134). Regionally, the employee nominal contribution rate has some way to go to meet the Singaporean rate of 20% but it is above Thailand's and Indonesia's. Similarly, as percentage of GDP, the Philippine contribution is above those two countries with a wide gap between the bottom three and the regional leaders of Singapore at 8.5% and Malaysia at 4.9%.

The SSS is the largest pension fund for the private sector in the country and is therefore one of the largest institutional investors in the country with GSIS.

8.3.1 Corporate Governance at SSS

For SSS, introducing corporate governance into the organisation has taken a more extensive form than GSIS or DBP. The motivations for implementing corporate governance at SSS happened in the wake of the Enron collapse, conversations with the ICD, the OECD corporate governance code for SOEs, and the imprimatur of then SSS Commissioner Corazon De La Paz.

The organisation received help from ICD in formulating its corporate governance code. Its then Commissioner De La Paz also used to sit on the board of trustees of the ICD and had intimate knowledge of the work of the organisation in promoting corporate governance. The ICD has also extensively worked on introducing corporate governance (or public governance) into the government sector:

“We are in the process of writing our own Code of Corporate Governance within the SSS but we are trying to align it with the code of corporate governance with the ICD for the GOCCs. [The current corporate governance codes] are mostly on the shareholder side so we plan to bring it down to the management level... There must be [input] from the management level and the employees. The corporate governance [code] will align with the ICD. It will be similar to the SEC code of corporate governance.” – SSS

The influential 2005 OECD Guidelines on Corporate Governance for Stated-Owned Enterprises (SOEs) was another factor. Like its equivalent 1999 Corporate Governance Code for the Private Sector, the OECD Code for SOEs is becoming more influential in developing countries where the government sector is larger than the private sector and government owned enterprises are more extensive and wide-ranging. Illustrating this point, there are more government owned corporations in the Philippines than there are listed companies (Moreno 2006).

Again, mirroring the experience of the 1999 Code, the 2005 Code has proven to be more relevant for developing countries when they were intended for SOEs in developed countries in the first place. Improving corporate governance in OECD SOEs carry with it the principal motive of eventually privatising these SOEs:

“...good corporate governance of State-Owned Enterprises is an important prerequisite for economically effective privatisation, since it will make the enterprises more attractive to prospective buyers and enhance their valuation.”
(OECD 2005: 9)

SSS sees the value of the OECD Code but the question for the organisation is the matter of operationalising the Code and making it relevant within:

“I attended a roundtable discussion on the Asian experiences of corporate governance for GOCCs hosted by the OECD. So the principles of the OECD on the public sector came up. We’re trying to come up with our own, and not just copy and paste it with the OECD [as the SEC did]. We’ll try to copy, improve it and make it more applicable. We are trying to adapt it to our situation here at SSS. There is a taskforce that will do that.” – SSS

Finally, the support of the SSS Commissioner in promoting corporate governance in the

organisation is fundamental. Effective corporate governance in the Philippines is championed by respected members of the community. For SSS, then Commissioner Corazon De La Paz championed the corporate governance cause within the organisation. Having worked for most of her career in the private sector and wooed to head SSS, De La Paz was familiar with the principles of corporate governance being practised in the private sector.

Under her tenure, four pillars of governance were established for SSS: financial viability, sound investments, quality service and corporate culture. All SSS programs revolve around these four pillars. The corporate governance lynchpin comes under the pillar of corporate culture with the various documents and training introduced:

- Code of Corporate Governance
- Corporate Governance Seminars and Training for Directors⁹⁰
- Code of Ethics and Personnel Manual

The Code of Ethics is seen to formalise expected ethical behaviour in the organisation:

“We are going to have a Code of Ethics which will be completed prior to the Code of Corporate Governance and there’s also a Personnel Manual which covers the do’s and don’ts for an employee. We are moving on creating specific policies on governance.” – SSS

For SSS, the two codes and manual are seen as guidelines on employee behaviour that are organisationally specific and relevant. This is how corporate governance is seen and operationalised at an entity-wide level at SSS.

8.4 Amalgamating GSIS and SSS?

In 1995 it was suggested that the two pension funds merge over the perceived duplication of their services. In the World Bank publication, “Philippines: An Agenda for the Reform of the Social Security Institutions”, the amalgamation of GSIS and SSS was one of the main recommendations of the report. While the document is an extensive scrutiny of the strengths and weaknesses of both pension funds, the report also

⁹⁰ This was in order to follow an April 2007 Presidential Memorandum that required “All directors of GOCCs and GFIs are required to take an orientation seminar on corporate governance.” Slide No.2 from Moreno (2008)

contained – with the benefit of hindsight it may now be considered as optimistic - extensive plans on the structure of these two funds as they transitioned into one (1995: Annex D). Combining the two funds was justified according to reasons of rationalisation, portability, efficiency and improving asset management as reproduced in the following table:

Table 34: Rationale for the merger between GSIS and SSS (World Bank 1995: 105)

Rationale	Reason
Rationalising the Social Security Sector	“... the current structure is beset with an artificial segmentation of membership, a multitude of plans for the public provision of social security, differing contribution and benefit rates, the absence of portability, and a lack of transparency. Since the SSS and the GSIS are the major players in the sector, a merger between them would go a long way toward rationalising the sector.”
Easing of Problems of Portability	“Although recent legislation provides for portability, the specifics have not been worked out and might be complicated given the differences in contribution rates and benefits. It will also involve recurring administrative expenses. A merger and rationalisation of the basic social security programs into a common contribution and benefits formula would help resolve these difficulties.”
Improving Efficiency	“While specific financial and operational reforms can also contribute towards improving efficiency, efficiency gains can be achieved by economies of scale from merging branches. There are at least 27 locations where both the SSS and the GSIS maintain branches. Efficiency gains would also be achieved by pooling the human resources from the two institutions. Some of the skill requirements are job-specific and in scarce supply.”
Improving Asset Management	“Through a comprehensive reform, it would be easier to pass new legislation which will cover all facets of social security including asset management and related policies. Changing asset allocation practices and adopting portfolio diversification principles would enable the social security system to play a more active role in developing the capital market. The privatisation of the asset management function will further deepen the financial market.”

However at the time of writing this proposal remains a suggestion. The organisations differ culturally, in stakeholder perception and participation, and in serving the needs of their respective members. Unlike corporate governance reforms, this coercive institutional isomorphism from an external institution did not occur. Indeed, the proposed merger has not progressed beyond the pages of the report.

8.5 Investment Portfolio and Strategy of the Funds

The investment portfolio of both GSIS and SSS are legislated in their respective charters:

“There are certain ceilings limiting the amount of investments that can be made in different financial products and sectors. These policy guidelines or parameters are issued to set out limits on domestic and global investments...Section 36 (j) of the Republic Act states that GSIS must make investments in companies that have shown profitability. This [Act] is our bible⁹¹. This sets out specific guidelines [for our investments].” – GSIS

Therefore, the investment strategies of the pension funds are restricted by these legislated requirements and to meet social obligations as outlined in their charters. Decisions must closely follow their respective charters and cannot be overruled by the board:

“In private sector corporations it is the decision of the board that will prevail with regard to making company investments but that’s how they practice in industry.” – GSIS

Both pension funds have a fund where members’ contributions are pooled. For GSIS, the fund is called the Social Insurance Fund,⁹² while the SSS equivalent is the Reserve Fund.⁹³

⁹¹ This description was prompted when I read the Useem quote in the Theories of Corporate Governance book. I told them the Theories book was my bible for my research.

⁹² This is outlined in Section 34 of the GSIS Act: “All contributions payable under Section 5 of this Act together with the earnings and accruals thereon shall constitute the GSIS Social Insurance Fund. The said fund shall be used to finance the benefits administered by the GSIS under this Act. In addition, the GSIS shall administer the optional insurance fund for the insurance coverage described in Section 26 hereof, the Employees’ Compensation Insurance Fund created under P.D. 626, as amended, General Insurance Fund created under Act No. 656, as amended, and such other special funds existing or that may be created for special groups or persons rendering services to the government. The GSIS shall maintain the required reserves to guarantee the fulfilment of its obligations under this Act. The funds of the GSIS shall not be used for purposes other than what are provided for under this Act. Moreover, no portion of the funds of the GSIS or income thereof shall accrue to the General Fund of the national government and its political subdivisions, instrumentalities and other agencies including government-owned and controlled corporations except as may be allowed under this Act.”

⁹³ This is outlined in Section 26 of the SSS Act: “All revenues of the SSS not needed to meet current administrative and operational expenses incidental to carrying out this Act shall be accumulated in a fund known as “The Reserve Fund.” Such portions of the Fund not needed to meet the current benefit obligations shall be known as the “Investment Reserve Fund” which

Each fund is then used to invest in different asset classes with expected returns meeting each fund's future actuarial requirements. The type of assets these two funds are allowed to invest in and the legislated ceilings is set out in the table in Appendix 6. This table covers the mandated financial instruments and limitations on how much the fund can invest in that particular asset type or financial instrument and compares section 26 of the SSS Act and section 36 of the GSIS Act. For SSS in particular, the limitations and ceilings on the type of investment are extensively articulated in Section 26 of the SSS Act:

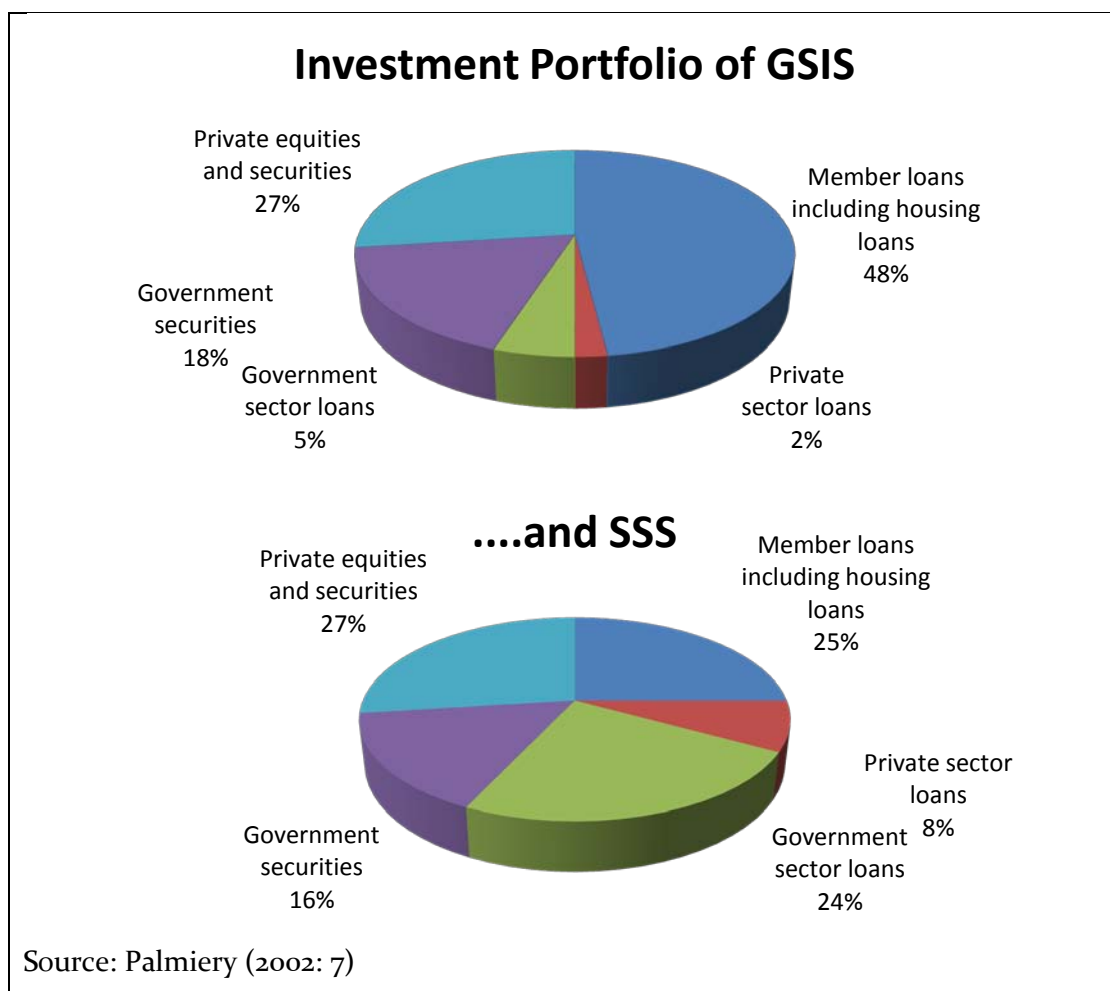
“...cumulative ceilings as follows: 40% in private securities; 35% in housing; 30% in real estate related investment; 10% in short and medium-term member loans; 30% in GFIs and GOCCs; 30% in infrastructure projects; 15% in any particular industry; 7.5% in foreign-currency denominated investments.”-SSS Act

For GSIS, its Act gives it more discretion than SSS in terms of its investment ceilings for all asset types with the main exception being the limitation on housing loans to GSIS members which is capped at 40% (see Appendix 6; section 36 (c)).

The investment limitations in pension funds from emerging economies like the Philippines have come in for some criticism as being too restrictive and conservative, while pension funds based in OECD countries have more flexible ceilings giving these funds more autonomy (Ghosh 2006: 135, Hess & Impavido 2003) . The following figure compares the portfolio mix of the two funds at the end of 2001:

Figure 40: Comparison of Investment Portfolio Mix between GSIS and SSS (2001)

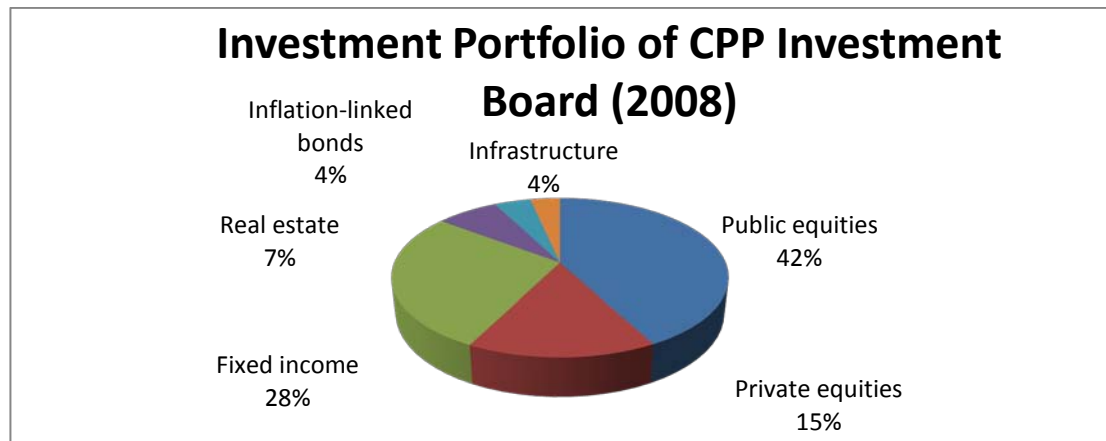
Commission shall manage and invest with skill, care, prudence and diligence necessary under circumstances with such matters would exercise in the conduct of an enterprise of a like character and with similar aims...in line with the basic principles of safety, good yield and liquidity, the Commission shall investment the funds to earn an annual income not less than average rates of Treasury bills or any other acceptable market yield indicator...”



For SSS, the portfolio mix is more evenly distributed with private equities and securities the most dominant at 27%. The old investment adage applies of not putting all eggs in one basket. For GSIS, a high proportion of their investment portfolio is loans made to members at nearly 48%. Given the ceiling of a 40% housing loans, the 8% presumably is made of other loans. At the end of the GSIS interview, with some relief a representative stated “I am so glad you didn’t ask about our non-performing loans.” I asked rhetorically, “What about your non-performing loans?” However the issue of NPLs was peripheral to the research and pursuing this avenue was an option not exercised.

In comparison, the next figure illustrates the portfolio mix of the Canadian Pension Plan Investment Board (CPPIB 2009) - the investment arm of the Canadian government’s pension fund. In 2009, the fund was valued at C\$108B and is an example of a depoliticised, independent government pension fund from an OECD country:

Figure 41: Investment Portfolio Mix of CPPIB (2008)



The fund's investments are in three areas: equities, fixed income and inflation-sensitive assets (CPPIB 2009b). At the end of 2008, most of the fund was invested in publicly listed and private equities at around 57.5% or C\$USD62.7B of the total portfolio (CPPIB 2009c). The fund's portfolio does not provide loans to its 17 million members and beneficiaries. (CPPIB 2009d)

Interviewees acknowledge the conservative nature of their charter's ceilings and inherent limitations in their investment decisions:

"Most of our funds are invested in government securities (sovereign guarantee undertakings), [and are] protected from external [shocks]. There are also layers of authority with committees to approve investments. The Commission of Audit [will] look at whatever adverse conditions there are [such as what] crisis in Asia will bring. Our investments are relatively safe – we hold on to them. We have short-term government (Treasury bills) held for a maximum of 1 year, 364 days; Then we have 180 days, 90 days T-bills. For the long term, we invest in Treasury bonds: from 2 years to 25 years. We have [currency]-denominated long term bonds with the earliest [having a] maturity date of 2014 while the longest will mature in 2032." – GSIS

However, at the same time, investment cultures in both funds are also shaped by events and/or personalities. At GSIS, the impact of the East Asian crisis produced a conservative approach in making investments:

"Crisis is our lifestyle. Basically the Philippine investments were pretty resilient to stay afloat. Government agencies and instrumentalities – we have remained safe. Investments remained secure. The whole region was affected by the crisis, we

have remained steadfast, but we have regained [from the crisis]. Some have been affected. The investment aspect of GSIS is very good. We managed to maintain our stability. GSIS manages the pension fund and the huge amount of money contributed by its members. The investment policy, therefore, is very, very conservative to staying afloat during the crisis. Post-1997, our expectations to recover are already here and have recovered under GMA. We thrive in crises.” – GSIS

At SSS, the background of each SSS head influenced a different type of investment culture under their tenure:

“The [discussion of] investments at the board level – it’s a matter of culture. At the time of President Corazon Aquino, Mr. Jose Cuisia was appointed (Phil Am Life, ex-BSP head). Since the Charter allowed flexibility, there was a little diversification, and the benefits started to improve. He was a businessman, so he looked at those things. [This was in contrast] with [a previous] administrator [who] promoted investment] in banks, [he was on the] very safe side; [compared to] Cuisia [who was] aggressive [in investing].

“There was significant improvement in our funds –our fund grew 6 times between 1979 and 1989. The fund management became more diversified when handled by bankers; then [someone from the] military was appointed then [someone from] the banking sector. [In the 1990s, there were] aggressive [reforms] with computerisation - and as far as [this head] was concerned, [he was] more of an operations person. With the change to De La Paz, the priority was to clean up SSS first when the cases⁹⁴ happened. She was more conscious of [restoring the reputation of SSS].” – SSS

Investment restrictions do have an effect on the organising of these pension funds. The next section looks at the long-term sustainability of the funds.

8.5.1 Actuarial Life

The importance of meeting the fund’s actuarial requirements is also an important

⁹⁴ See section on Politicisation of the Pension Funds

consideration in investment decisions. In 2007, GSIS's minimum return was an annual yield of 12%:

“Before we proceed on government projects, the imprimatur of the board of trustees, we have existing limitations. We don't investment if we expect a return lower than required. For the Clark [Air Base] project, we require that it will generate a minimum return of 12% which is our actuarial requirement. Anything below the 12% - which is the magic number - we can't sustain the services and needs of our members. On an annual basis we need a 12% return on everything we have.

“Our primary concern is always geared towards our members. GSIS has actually computed this magic number to sustain operations, benefits – future benefits. The fund should last 25-30 years so that we can ensure we have enough funds. 12% is the magic number. We have reduced our housing loans as actuarially they don't meet our yield requirements. For example with the Clark venture, any amount lower than 12%, we doubt that the Board of Trustees will give its imprimatur financially.” – GSIS

For SSS, news in 1999 that the actuarial life had shortened as the payment of benefits exceeded member contributions threatened the viability of the Reserve Fund. A joint World Bank and ADB report highlighted the financial problems faced by the fund and mentioned the necessity to immediately address the problems of decreasing contributions and inappropriate misuse of funds:

“...If the SSS does not increase its contribution rate or extend the contribution period, it is estimated that its resources will dry up by 2015...reported misuse of the fund also inflicted losses on the SSS.” (World Bank and ADB 2003 – see pp. xii, xv and 11)

The crisis in the life of the SSS fund added to the conservative investment decision making culture in the organisation as the fund tries to recover and regain its ideal yield:

“At the SSS the yield should be around 12% but at the moment it's 7% so we [are trying] to get it higher. In 1999, there was an actuarial valuation and the big news was that SSS only had funds up to 2015, saw there was an increase gradually. The

actuarial fund is now expected to last until 2031. The new actuarial valuation this year [2007] is expected now to go up to 2038.”– SSS

Ensuring these funds are financially sustainable to meet and provide income security for retired employees mean their investments must be prudent. The next section looks at the capital market investments by the funds.

8.6 Capital Market Participation by GSIS and SSS

In this research, the most relevant aspect of the investment portfolio of GSIS and SSS is with their investments in the capital market through private equities and securities. As institutional investors, their investments in publicly listed corporations give them the privilege and leverage to be active participants and influence decisions in companies they are erstwhile owners of. As substantial owners of publicly listed companies, GSIS and SSS become both a significant shareholder and stakeholder in the corporate governance processes of the organisation. From this section onwards, the corporate governance role and influence of GSIS and SSS are discussed.

Capital market investments made by the pension funds occurred gradually. In GSIS, stock market participation occurred from the 1970s onwards; subsequent bull runs encouraged the GSIS participate more in the PSE:

“Active participation of the GSIS in the stock market resumed in 1998 when the volume of transactions in the exchange started building up, partly triggered by the entry of foreign investors and strong interest of domestic investors.”

(Palmiery 2002: 10)

For SSS, their foray into the stock market did not occur until 1987. Participation of both GSIS and SSS in the PSE increased market confidence and encouraged share market participation. (Palmiery 2002: 12) Indeed, their marked can only contribute to the virtuous cycle of capital market and corporate governance development in the country. Through these funds, a member of either GSIS or SSS is indirectly a shareholder of a Philippine public corporation. Where Philippine retail investors are few on the ground and stock market speculation is still seen as an elitist activity, a significant proportion of the population can claim to be a minor owner in a publicly listed company through these funds.

8.6.1 Capital Market Investments

Given the limitations in their charter for both funds, the funds' investments in publicly listed companies are nominally restricted to the blue-chip corporations – that is corporations who have had a proven track record of three years profitability with payment of dividends at least once over the same period (see Appendix 6: Section 26 (i) of the SSS charter; Section 36 (h) of the GSIS charter). Thus when interviewed, the list of companies the funds invest or have invested in are generally the well-regarded ones.

In 2007, GSIS was divesting in PSE listed corporations as they were looking at global investments given the limitations of the domestic market (this is treated more extensively in a later section in this chapter – GSIS' search for a Global Fund Manager):

“We currently now have investments in 20 companies on the PSE. We have sold SMC (which we held for 10 years) and sold our Ayala interests. Our biggest share holding is in the First Philippine Holdings. We have had big shareholdings on SMC, Meralco, PLDT, Basic Consolidated Incorporated. We have a board seat on Meralco, Basic Consolidated Inc. We are currently divesting as we are going to go global (with investments). In 2006 we had P33B worth of investments in the PSE listed companies, this year it's down to P10B.” – GSIS

Similarly with SSS, the profitability required by their charter is a fundamental consideration:

“There are guidelines on where to put our investment in. PAL [Philippine Airlines] has not posted a return and there's no track record of profitability. If we look into a company, they must be profitable for the last 3 years. PAL was affected by the [East Asian] crisis. The equities that we have are blue-chip stocks: infrastructure, utilities, SMC, PLDT, Meralco, banks, a bit of mining. We have a diversification issue – don't put all our eggs in one basket. We have a set limit for equities. We used to be in PNB. On the PSE we have around 20 stocks. It's the same amount over the past 10 years.” – SSS

While a change of President and administration also means a change in the investment culture

“We started becoming aggressive when Estrada came in. There was an increase in putting investments into equities. Now it’s very limited [as a result].” – SSS

Capital market investments by the funds take into consideration the tensions within and outwith the organisation.

8.6.2 Socially Responsible Investments

With socio- environmental concerns at the fore, socially responsible investments (or SRI) have been a concern for institutional investors and fund managers in the past decade (Clarke and Dela Rama 2004). The notion of SRI has not gone unnoticed in the Philippines.

For SSS, there is an emphasis that investments in the capital markets must also be done in a socially responsible way. A decision to invest or not invest in a certain company or sector must be justified especially if such investments may have detrimental social effects. When holding a major stake in a corporation, the SSS also exercises its leverage if the corporation decides to enter a less socially responsible sector:

“There are very strict guidelines where we’ll put the funds of the SSS. It specifies those terms. There are specific investments, the types of investment, the yield. We can’t invest in gambling, other vices, cigarettes. Not investing in cigarettes is unwritten rather than written in the charter but it has been followed – to avoid investing in them unlike GSIS. And we don’t invest in [companies] that have profitability issues.

“On not investing in cigarettes – there is a morality issue involved – the previous [presidential] administration has tried to put a limit on investing in them...[If we have major stake in a corporation and] they decide to enter gambling or [build] casinos, [our CEO] De La Paz will have something to say about it. The morality issue is a safety issues as well. When there is an investment in vices, there’s also a speculative element and yield. Vice investments are speculative.

“We made an investment in Makati Medical Center. If we go into smoking, why are we funding hospitals? This kind of defeats the investments as they cancel each other out –that is, we are funding hospitals but also funding the patients for

the hospitals. [Our stance here] shows [our decision-making process with] what we do before we put our money.” – SSS

Socially responsible investments also mean investing in areas where profitability may not be the premium consideration. The capital market success of some of the Philippines biggest listed corporations has influenced the organisation to take a more focused approach on other sectors of the economy that are not receiving as much investment attention:

“The [investment in] equities allow us to lend or to give loans to private corporations. There is now less need to give it to huge corporations, so now we’re looking at SMEs. There is also the social side – [our loans] should generate jobs, so we look at tourism-oriented projects. We also invest to avert power crises – we have power subsidies, and also those involved in education and high schools. We give loans to schools and hospitals. We lend knowing that some would not make a profit but [this is less of a consideration] because of the social impact and benefit [their impact would have on communities]. For example [we are] investing in the housing sector– it is a bad [sectoral] investment and [investments are] hard to recover.” – SSS

For GSIS, socially responsible investments and corporate social responsibility are closely connected:

“If you’re talking about CSR, it’s a policy for our national government. Under the law there are types of industry [that we don’t invest in]. For example, there is a government policy prohibiting investing in nuclear power; also anti-terrorism - no investments to be made in the reproduction of armaments under the country’s terrorism laws.” – GSIS

With a definite acknowledgement in the way investments are normally linked to the political wishes of the day:

“SRI for GSIS depends on public policy. Policies of social responsibility are connected with government policies. If the government launches a new SME funding project, for sure it will ask GSIS to contribute in the form of direct lending, wholesale lending to our members, microfinance, and life in the country. More often [than not] GSIS is asked to participate in the program.” – GSIS

While funds are well aware of their SRI obligations, the political environment means these two funds must navigate through this minefield and ensure they do not alienate powerful stakeholders.

8.6.3 Nationalism, Parochialism and Global Investments

As mentioned earlier, there are legislated limitations on the investment policy and strategy of both pension funds. Both are severely restricted in terms of their investment allocation guidelines. Most investments are focused on peso-based financial instruments, which according to one interviewee:

“...is a very narrow basis. The conundrum is the peso has the lowest rating – a junk rating for a currency.” –private sector 1

The parochialism towards moving the pension funds to invest in other foreign investments is a matter of nationalism:

“This foreign resistance is not well advised. It is uninformed. It is matter of information and national resistance. Main Street USA has the same attitudes.” – private sector 1

The nationalistic reasons for not investing overseas have had a patched history with a start-stop approach at GSIS:

“In pursuit of diversification, the GSIS in 1994 invested in foreign markets with a USD10M initial exposure. The venture became profitable but it had to pull out the funds after 2 years due to government and public pressures.” (Palmieri 2002: 10)

These restrictions are well-acknowledged by GSIS representatives. The limitations placed on the foreign investment expansion reflect the somewhat myopic and parochial nature of the organisation’s masters:

“GSIS does not have any funds in the USA except in mutual funds...Global investments are just being developed now. Here, the view is that we should concentrate our investments in the Philippines. The feeling or the view is that investments overseas are unnationalistic or unpatriotic.” - GSIS

I further probed this reluctance by discussing with my pension fund interviewees about this misunderstanding about investing overseas. I pointed out that Filipinos are great consumers of overseas goods. The tendency to buy a Western product can be seen as buying into a part of the Western lifestyle⁹⁵. If Filipino consumers buy Coca Cola or Nestle products, surely it would be logical to buy into the Coca Cola or Nestle companies as shareholders; shareholders receive income in the form of dividends. Simply consuming a foreign product brings immediate gratification but no long term benefits; every Filipino buying a pair of Nike shoes are adding to the income of Nike, sustaining its shareholder value and contributing to its dividends. Wouldn't it be better to buy into the company and receive dividends?

“[Filipinos] understand buying easily but not investing. Those [Western products] are things we use every day but if you talk about stocks – for them, the common person, you are investing overseas. It must be explained why this is thus, why investment [is going overseas]...there is a lack of investor understanding.” – GSIS

Similarly, at SSS, while its charter gives it leeway or possibility to invest overseas, the political pressures are such that it is more prudent not to and err on the side of caution:

“As for the SSS going global, our charter gives us the leeway to go global but it's controversial. It's a sensitive issue. Why are we investing elsewhere? Congress asks us why we're going to invest overseas.

“In the charter there is a leeway for us to invest up to 7.5% in foreign investments under section 26, subsection (2) (j) and (k). So that section does give us the ability to invest overseas but we currently don't have any foreign investments. Our charter also allows us to invest in foreign currency but it must be non-speculative, non-equity investments.

“We will probably go global and the commission recently approved a direction to go into global foreign investment. But we have to be cautious about it. We know

⁹⁵ The extensive shopping bazaar of Greenhills in Manila is also testament to the availability of counterfeited Western goods (at affordable domestic prices) in the country. Classen & Howes (1996) looks at the psychological and socio-economic impact of Western consumption in emerging economies.

we can't do it [yet]. It's in the pipeline...we require a good yield at the moment." – SSS

Global investments remain a contentious issue for both funds.

8.7 GSIS' Search for a Global Fund Manager

The small, domestic capital market of the Philippines places limitations for investment portfolio diversification for any investor yet investing globally to diversify the portfolios of both funds is also frowned upon. (Palmiery 2002: 15-16)

While SSS was still conscious of its role in a politicised episode (see Politicisation of the Pension Funds in this chapter) and therefore took a more conservative and guarded approach to investing in both domestic and international equities, GSIS was free of any lingering legacy issues. Notwithstanding the existing stakeholder parochialism at the time of the GSIS interview, the organisation was engaged in the process of finding a global fund manager (GFM) to manage their foreign investments up to the tune of USD1B of the fund's investable assets under the fund's Global Investment Program (GIP).

To meet the investment returns of the GSIS fund, the alternative to the small domestic market is to take advantage of going global and investing beyond one's national borders. Thus, the search for the GFM was rationalised with a strong emphasis that unlike most appointments in the Philippines, this was not a political one. The search had an uneasy birth as it had to be vetted through the typical political obstacles. Given the political support for PGM Garcia, the timing for the Global Fund Manager was just right for the organisation. Nevertheless, a certain amount of political struggle had to be experienced before the go ahead was given for GSIS as the following statement relates:

"Currently we are looking for a global fund manager to manage our international investments. We tried several years ago to introduce this but it was prevented and stopped by the then PGM, then by the Senate, then by Congress." – GSIS

For GSIS, the search for the GFM was also a way for the organisation to mitigate the political interference known only too well by governmental organisations given past experience; hence with GSIS' international investments and political global fund managers, there could be little substance to allegations the process and investment decisions were being politicised:

“But now we are ready to introduce a Global Fund Manager. For this Global Fund Manager position, we have issued a tender and asked for proposals to be submitted by June 11. In late August, the board would have approved [the proposal] and by the end of the year there ought to be the Global Fund Manager. This is not a political appointment. The shortlist may include Lloyd’s, Merrill Lynch. It might be better to have two Global Fund Managers for a period of time – [so we do] not have all eggs in one basket. For example, for European investments [we have] a European Fund Manager; for American investments, [we have] an American Fund Manager.

“The GFM is something new, [it’s] uncharted territory. Gains may come from investing overseas. [This is the] reason the PGM [states] why we’re going global is the local market here is already saturated. So we are looking at investing in other potential markets.” – GSIS interviewee

Outsourcing the role of GFM is an acknowledgement that GSIS has little in-house technical expertise to manage global investments (Palmieri 2002: 17):

"This will be the first time for the GSIS to invest abroad at this magnitude. We still do not have the necessary technical expertise to provide a good asset allocation consisting of global instruments," he said. "Foreign fund managers, on the other hand, have their ‘ears on the ground’ consistently and would be in a better position to propose an asset allocation." PGM Garcia (GSIS 2007 Press Release)

The search for the GFM was done in a methodical way. GSIS sought the advice and experience of another institution which has been through the process before. From one pension fund to another, the PGM of GSIS went to the most well-known pension fund in the world, the Californian Public Employees’ Retirement System (CalPERS)(which had an investment portfolio valued at US\$165B in February 2009 (CalPERS 2009), for direction in the process of finding or short-listing the GFM and managing global investments:

“Our PGM went to CalPERS last month and tried to investigate [their actions] and they came up with parameters. [We have] request for proposals [which is] regarding help with [finding] the GFM. What [we] picked up from CalPERS [by]

meeting with them is part of the requirements. We are using what were some of the CalPERS requirements for their GFM here at GSIS.” – GSIS interviewee

Other pension funds GSIS reviewed for its GIP included “the California State Teachers’ Retirement System, as well as the direction being taken by Asian neighbours such as the National Social Security Fund of China, the Government Pension Fund of Thailand and the Employees’ Provident Fund of Malaysia.”(GSIS 2008b) The search for the GFM was narrowed by the requirement that a proposing organisation have at least USD100B assets under management: the GFM of GSIS must have sufficient experience. Documents relating to the request for proposal for the GFM of GSIS were posted on the GSIS website to show that the process was done in a transparent way:

“A total of 36 global fund managers and four global custodians submitted their proposals. The criteria for the selection and the relative weights of each parameter were also published in the website, as well as questions raised by the interested parties and the corresponding answers of the GSIS. This ensured that all participants have the same level of information needed to prepare their proposals to the GSIS,” Mr. Garcia said.” (GSIS 2007b Press Release)

An abridged version of the proposal questionnaire and the proposal evaluation matrix are outlined in Appendix 7. The evaluation matrix shows the weight of each issue as judged with the proposal. The questionnaire covers issues of the potential fund manager’s investment strategy, historical performance, risk management, organisation and investment philosophy and style.

8.7.1 GSIS, the Global Fund and the Global Financial Crisis

Timing is everything.

In the latter half of 2007, the sub-prime crisis in the USA was unfolding which would eventually engulf the world in global financial crisis not seen since the Great Depression. By 2008 major collapses of certain developed economies, and government bailouts or nationalisation of financial institutions such as global investments banks occurred (Stiglitz 2010, Johnson & Kwak 2010).

In the GFM questionnaire, the issue on risk management included a question relating to the US sub-prime crisis: “What were the actions instituted to reduce the negative effects

of global economic events such as the recent sub-prime crisis and weakening of the US\$?" indeed, GSIS was proceeding ahead with full knowledge of market instability.

For GSIS, going global as most developed economies were contracting provoked questions on the timing of such an initiative (Business Mirror 2009). Hence, after the first year of the GIP, the results for GSIS have been mixed. Financially, the annualised returns for its global investment portfolio are yet to meet the required target of 8%.⁹⁶ Organisationally, the appointment of global fund managers has been a success - investment decisions are made by a third party outside the politicised environment of the country. In 2008, GSIS announced a second round for its GIP (GSIS 2008c: 1) and in March 2009, American financial institution, JP Morgan was appointed as the custodian for GSIS USD1B global investment program (JP Morgan 2009):

In 2007, GSIS explained their intention and investment strategy to appoint a global fund manager to manage their foreign investments. By 2009, this intention and strategy have been successfully executed. In 2009, GSIS is an institutional investor in geographically and sectorally diverse multinational corporations.⁹⁷

The selection processes for the fund managers have been transparent. GSIS has European fund managers managing their European investments; and American fund managers managing their North American investments. On face value, the organisation is showing signs of confidence in the direction the organisation has proceeded with its foreign investments.

⁹⁶ In the 2008 RFP, it is outlined: "For its global investments, GSIS seeks to obtain consistent positive investment returns with capital preservation and sufficient liquidity over a three-year period. The specific investment objectives are as follows:

* 7.1 Target return. The return on the Fund in US dollar terms should be at least an average of 8% per year (net of management fee).

* 7.2 Volatility. The Fund should have an average volatility of not more than 7%.

* 7.3 Liquidity. There should be adequate provisions for an exit mechanism in case GSIS wants to liquidate the investment. (GSIS 2008c: 2)

⁹⁷ GSIS' foreign portfolio include investments in the following corporations: "The pension fund's stocks in large nonbank US companies, such as Pfizer Inc., Kraft Foods Inc., Newell Rubbermaid Inc., Sara Lee Corp. and FootLocker Inc...and stock investments in Spain's Banco Santander; France's BNP Paribas; Italy's Intesa San Paolo and UniCredit Group; Ireland's Allied Irish Bank and Irish Life & Permanent Plc.; Denmark's Danske Bank; Sweden's ForeningsSparbanken AB; Britain's Cattles Plc. and Aviva Plc.; Israel's Bank Hapoalim; Singapore's DBS Group Holdings Ltd. and United Overseas Bank; and Indonesia's Bank International, Bank Negara and Bank Rakyat, among others." (Business Mirror 2009)

8.7.2 International Investment Experience of Other Pension Funds

GSIS' experiment into the world of international investing has a long way to go to match its developed country counterparts. The Canadian pension fund, CPP Investment Board has been investing in infrastructure projects worldwide, including those owned by Australia's Macquarie Group. The reputation of the CPP Investment Board is such that it attracts private sector talent to cross the divide and join the public sector fund and unlike GSIS and SSS, its government owners take a hands-off approach (Johnston 2009). The number of fund managers CPP Investment Board has on its books is also substantial:

“CPP has more than 60 investment houses overseeing its private equity mandates and another 40 or so sharing its giant equity and property mandates,” (Johnston 2009)

Similarly, Australia's Future Fund has an extensive list of fund managers for each asset class. As at May 2009, 11 asset classes were overseen by a 42 financial institutions (Future Fund 2009). If going global indicates a more independent and depoliticised GSIS, then at least in this regard, GSIS has achieved success. The sometimes drawn-out affair and piecemeal reform of allowing a government financial institution to function according to its mandate has clear advantages for both the organisation and the country. The GFM experience is testament to the wisdom of having a more independent GSIS.

8.8 Politicisation of the Pension Funds: The Equitable PCI episode

“How can you say no to the President of the Philippines?” -GSIS

While the previous section highlights the advantage of depoliticised investment decisions, this is not the norm. Investment decisions for both funds are normally politicised. This section narrates an episode showing the heavy politicisation of both funds.

Both pension funds have a history of being politicised and influenced by the government of the day. The breadth and depth of funds these two organisations hold are a temptation to divert and use them from their intended purpose allowing them “to deviate from the fiduciary principles.” (Palmieri 2002: 14)

Under the Marcos regime, GSIS (with DBP) were directed to fund “the construction of hotels as a result of the government’s bid to host the World Bank and IMF meeting in Manila. Most of these hotels were later privatised in the late 80s and late 90s. It was also during this period that the GSIS took over ownership of PAL, the Philippine flag carrier.” (Palmiery 2002: 9) According to Palmiery and substantiated by the SSS interview in the next section, SSS managed to remain unnoticed from the Marcos radar with investments made in relatively controversial-free financial instruments (Palmiery 2002: 11).

A more recent case of politicisation which heavily impacted the pension funds occurred with the previous president, Joseph Estrada. According to a 2007 World Bank Report, it is estimated that Marcos embezzled between USD5B-USD10B during his lengthy reign; on the other hand Joseph Estrada, president between 1998 and 2001, managed to embezzle between USD78M and USD80M in the three tumultuous years he presided over the country. (Gill & Kharas 2007: 315)

Under the Estrada presidency, the pension funds directly experienced politicisation with regards to their investment strategies. This reinforced the view that for government financial institutions, they must be prepared for every political crisis that besets the country and that the President’s self-interests are carried out sometimes to the detriment of the country.

The case of Estrada’s interference with the pension funds occurred with share market speculation over financial transactions relating to a bank merger between the companies Equitable and PCI. There was a strong suggestion emanating from the Palace to invest in the bank PCI, which stands for the Philippine and Commercial Industrial Bank.

Two of the major shareholders in the PCI bank were the Lopez and Gokongwei families and their combined shareholdings formed a block. This block was sold to Mark Jimenez, a stockbroker who was a member of Estrada’s inner circle (Coronel 2001).⁹⁸ There were three banks involved that were looking at acquiring the PCI block: BPI, Metrobank and Equitable. Two of the potential buyers, BPI and Metrobank, stated their intent to buy the bank was conditional upon the completion of their due diligence over PCI. The last buyer, Equitable passed on the due diligence part and sought GSIS and SSS’ financial support in this partnership: “Equitable’s president George Go was a long-time Estrada

⁹⁸ Coronel’s article also provides a detailed account of the extent of Estrada’s business dealings during his tenure as president.

friend.” (Coronel 2001)

Therefore the three organisations had an equal split to buy into PCI: one third was with Equitable (and its owners the Go Family), the second third was with GSIS and the last third to SSS. While there was no direct, written order from Estrada to invest in into those shares, one interviewee pointed out the imprimatur of the Presidency:

“...this is the President - what the President wants, the President gets. In Philippine culture, all presidents have exercised a degree of influence over the whole of government – agencies and organisations. You cannot deny the president’s wishes.” –public sector 1

For both GSIS and SSS the political pressures from Malacañang Palace was sufficient enough for his wishes to be carried out. Both GSIS and SSS were suggested to invest in Equitable PCI:

“When the purchase was made, it was above board. The board of trustees and management committee approved it, and ok’ed the purchase. It was nothing irregular at the time.”-public sector 2

Combined, the pension funds - under presidential advisement (or some would argue duress) - bought P15B worth of Equitable PCI shares which represented 30% of the company: a hefty, substantial holding or “the biggest chunk.” For GSIS, they bought the shares at P90. The problem with undertaking this order was the enormous amount of money and volume in the share transaction involved. For GSIS, some P7B were invested in the Equitable PCI shares:

“What was wrong was the shares became volatile after [GSIS] purchase. There was so much insider trading involved that the shares dropped by more than 30%. It looked like we were losing on this transaction.” – GSIS

From Coronel’s account, the volatility on the PSE had much to do with the excessive premium paid for the shares and the scale of the commissions involved (Coronel 2001). These shares were later disposed to another banking conglomerate, Banco de Oro (which later took over Equitable PCI) being sold at P92 after being held by GSIS from 2002-2006. For GSIS, it made some money – a gain of P2 per share over the 4 years it was a substantial owner of the company.

For SSS, the story has had a different outcome and a more profound effect. In 2007, eight years after the initial share purchase, the organisation was still involved in the intricacies of the Equitable PCI purchase. At the time of SSS' purchase in 1999, the organisation was moving towards a different way of record-keeping – accounting adjustments to its books when it moved to mark-to-market for equity investments. Immediately after SSS purchased shares of Equitable PCI, the fund posted a loss of P75M as the shares decreased:

“We had, during Estrada, continued buying until we doubled our investment; the share price doubled; twice the original share price. From 2 board seats [originally our new ownership saw] this increased to 5 seats in Equitable. Right now, we can't close the sale of SSS' Equitable PCI shares. We're still under a Supreme Court restraining an order from selling the shares. The issue is still with the Senate. Once the Court rules, we will be able to sell them off. We've recovered [the sale of the shares] but the proceeds are at an escrow account. Once the Supreme Court lifts the order – at the higher price – we can post a profit. The share price [of the SSS sale] was posted in 2005.” – SSS

The undue political pressure on SSS overrode the organisation's charter and internal policies on equity investments:

“There was a lack of due diligence and governance over these shares as the former Commissioner advised that Equitable PCI [shares] be bought.” – SSS

While the direct order from the President to SSS to buy Equitable PCI shares was not officially recorded, the unwritten directive caused a great deal of harm as the public servants were caught between the proverbial rock and a hard place – how to justify these investment decisions within the parameters of their legal charters:

“Whether or not there was political interference with the shares, the documents we have showed a hasty deal. No due diligence was done when SSS bought the shares. We just don't invest in ordinary investments. There's a process that needs to be followed. Questions at this time was over due diligence. But no due diligence was done. The merger happened between Equitable (the Go Family) and PCI. The case we filed (now in the Supreme Court) is that the SSS funds were

used to aid the Go Family to help them buy PCI. If it were not for the funds of the SSS, the Go Family could not have bought PCI.

“The respondents to our case said it was a good investment. But our charter did not say we had to own a bank. The SSS continued buying the shares. In 2002/2001 – Erap (Estrada) was being impeached. During the impeachment, it was revealed that there was a Jose Villar account with Equitable but this was really Erap. That was a dummy account. The Equitable shares decreased and SSS bought more shares to prop-up the share price.

“If one of the justifications for SSS was for it to control the bank, why didn’t SSS own a bank? We had a majority ownership of Unionbank at one time where we had 3 board seats but it was divested. Our share has now decreased to 10% in Unionbank. At Equitable PCI, it was the first time we had the controlling interest but no control at all. In 2001, when De La Paz took over, we had the majority of seats. Our Investments Group (IG) is an internal group that makes investment decisions in companies. But did they invest in Equitable PCI directly? It goes through the stockbrokers - that’s why the former Chairman [told them to invest].” – SSS

SSS’ involvement with the Equitable PCI deal lingered on in 2007. For an organisation that managed to remain relatively unscathed under the Marcos years unlike the DBP; SSS’ capitulation to a president in the democratic era tested the organisation’s strength, mettle and well-being:

“It’s still a controversial issue. [Commissioner] De La Paz joined SSS at the time and maintains a hands-off policy. It was ironic as she was also the chair of Equitable PCI. We had the largest shareholding in Equitable PCI [before its merger with BDO.]

“We have recovered somehow. We are happy to get recognition from Social Weather Stations. On a survey of businessmen on which government institutions they think are making a conscious effort to fix graft and corruption – we got the #2 position after the Supreme Court. It’s a matter of getting over the corruption issue after the Estrada administration. It’s a credit to Ms. De La Paz’s leadership issue. Except for the Estrada administration, we have had a good reputation.

“Even in the Marcos era, SSS was clean and straight compared with GSIS during the era. The [SSS] administration at the time was very strict, very conservative. Why? Marcos let [us] be. [SSS] had one outside investment during that time – a loan to Philippine General Hospital for their facility. All earnings and contributions went into government securities. The biggest [investments were] handled conservatively. There was an ultra conservative investment policy [in SSS under Marcos]”. – SSS

Why then did Estrada strongly request these two pension funds buy into the company? One proposition suggested he was looking for funding sources for the next election campaign which he had hoped to contest – building the election war chest so to speak:

“The sale done on the holding – some said there were commissions that were paid to the government so they could be used to pay for the presidential campaign. It was pretty bloody. It’s the timing that came into question – whether or not there were funds that were exchanged over to private hands. There were commissions to be paid off to Estrada. The deal was overpriced by P1B. It was an overpriced deal.” – public sector 3

It also helped Estrada’s cause that he had friends and associates within SSS who helped him embezzle the funds: officers in charge of the respondent funds; and the previous chairman, Carlos Arellano. Psychologically, SSS’ involvement with the Equitable PCI issue had a devastating impact on its organisational well-being:

“Arellano got away scot-free from the [court] case. The lower court decided in SSS’ favour but since he was no longer in government, he is no longer part of the action. But the people left behind, those who stayed – there were suspensions.” – SSS

This involvement has also seen much cause for soul-searching and reform within the organisation. While not on the scale as the rehabilitation of the DBP, this episode nevertheless has made for a more introspective SSS:

“The present [SSS] board is more careful. There has been a precedent – fuelled by people inside. We are more careful as far as investments, deals and acquisitions are concerned. There has been an increase in due diligence and governance has improved. [Commissioner] De La Paz is careful with integrity – she is pushing for

governance reforms after what has happened. De La Paz is also strict with transparency and with unaudited financial statements.

“The GSIS annual report is unaudited. [There’s] a hard feeling that [SSS is still reeling over the scandal while GSIS has moved on.] De La Paz is careful after she saw the deal with Equitable. After the Gos sold [their shares in Equitable PCI], things have improved after that sale was done with BDO. We will keep the board seats until the final sale is consummated. ” – SSS

Estrada’s political interference with the pension funds had strong reverberations for the rest of the civil service. For one corporate governance regulator, this incident was a highly distasteful politicised episode:

“We must make sure funds of these pension funds are not used by the incumbent president for political ends. Former president Estrada ordered GSIS and SSS to invest in certain corporations – money that went there went down the drain.”- public sector 4

The after-effects of Estrada’s suggestion to the pension funds to invest in Equitable PCI had lingering, long-term effects. Apart from destabilising the capital market with such a purchase, disposal of the Equitable PCI shares took several years. In the interim, the Estrada suggestion imposed on the pension funds considerable ownership of a company and with it, the associated responsibilities as substantial block holders. Politicised actions rarely have short-term outcomes. The short-term monetary gain to then President Estrada had long-term repercussions for the pension funds although the former’s penchant for capital market speculation contributed to his premature ousting. The next section expands on the ownership – and later, onerous - responsibilities imposed on these pension funds.

8.9 Institutional Investor Influence and Leverage

When GSIS and SSS make investments in publicly listed companies, such purchases are normally substantial rendering them significant owners. As the country’s foremost institutional investment funds, the buying and selling activities of GSIS and SSS on the relatively small capital market of the Philippines have tremendous impact. When they make a foray in the capital market, they move it because the market is relatively narrow,

shallow and illiquid (Palmieri 2002: 16). The power and financial leverage of the funds are well-known:

“SSS and GSIS have investment funds of about PhP250 billion [in 2003], large enough to dominate the local stock market and initiate a takeover of any company in the country.” (World Bank and ADB 2003: 11)

“When we make investments, the market moves. Our investments have a significant impact on the stock market. We move the market. The GSIS starts trading when the market is languid. We initiate activity in the stock market.” – GSIS

Thus the pension funds are in an enviable position of having enormous amount of financial resources at their disposal:

“GSIS recently sold off shares so they have plenty of money to invest. They need to invest money. GSIS have investments in foreign countries – billions of pesos not only in Philippine instruments.” –public sector 1

As substantial owners, the pension funds are normally entitled to representation on a company board. In most cases, both GSIS and SSS are passive investors. During my interview at GSIS, I read out the following passage on the behavioural perception and expectations of an active institutional investor:

Table 35: Activist investors press companies for improved performance (Useem 1998)

Institutional investors press companies to...
<ul style="list-style-type: none"> • Redesign the company to be more competitive • Improve short-term and long-term performance • Retain effective strategies, abandon failing strategies
Institutional investors press companies by...
<ul style="list-style-type: none"> • Occasionally voting against management proposals • Sometimes voting against company directors • Sometimes demanding different managers • Often telling companies to alter structure and improve performance • Frequently meeting with company executives • Frequently asking for quarterly performance of units and products

-
- Almost always seeking more information on company plans
 - Increasingly demanding strong and independent boards of directors
-

Afterwards, my respondents stated that the description was not the norm in the Philippines and they were 'passive' investors. The exception was the PCI case where both funds were vehemently active as related in the following section. Nevertheless, Chris Mallin's observation⁹⁹ that active institutional investors can - and do - improve good corporate governance in companies that they invest in is yet to be realised in the Philippines.

8.9.1 Institutional Investor Activism on the Equitable PCI Board

With regards to the funds' representation on the board of Equitable PCI (similarly with other share ownership where the two pension funds have a large enough shareholding) entitlement to a board does not necessarily mean securing the majority voting rights. In the Philippine corporate governance environment where most corporations are family-owned, the lingering effect of family ownership creates a certain amount of entitlement from the original owner whether that be financial, emotional or both. A majority stake may still mean the deciding votes are still with the now minority, but family owners. In which case, the power on the board is still with the owners and not the institutional investors themselves:

"On Equitable PCI and other firms, our shareholding entitled us to a board seat. We always took advantage of our board seat, to see what was done. But our directorship was ex-officio, non-voting. Our [GSIS] President and General Manager (PGM) Winston Garcia was usually the director on those boards. If he was unavailable, he would designate the seat to someone else. " -GSIS

Occasions are rare when the pension funds work jointly together and exercising their leverage as institutional investors. When they do, such actions are notable:

⁹⁹ "Good corporate governance is therefore going to help build confidence in firms and in the economy as a whole, and so there are very good reasons for institutional shareholders to be interested in improving corporate governance in the companies in which they invest, whether they are home investments or part of a diversified international portfolio of shares" (Mallin 2008: 98)

“The only controversial actions that involved GSIS were with Equitable PCI. We worked with SSS to get the numbers of votes to let the owners of Equitable PCI know that we wanted director representation on the board. The owners are the Go Family and they wanted to protect their interest. This was a joint GSIS/SSS action in 2006 and the board was changed as a result. The board composition changed and another family, the Sy Family of SM Investments, finally got [onto the board of] Equitable PCI after GSIS sold its share [to them]. In short, this was the only record of us being very active.” – GSIS

“Historically, we only became active in Equitable Bank.”- SSS

The dispute over GSIS and SSS’ board representation on Equitable PCI spilled over into the public arena as the family owners of the company fought off its biggest investors:

“There were 2 board seats for GSIS on Equitable PCI. They were really screaming at the boardroom – both [GSIS’] Garcia and Ferdinand Martin Romualdez [the third substantial investor in the company] at the Equitable PCI board. [In 1996] it was all over the papers, fighting with the [company’s] leadership. Garcia and [SSS’] De La Paz were also at odds.” – GSIS

“The Go Family was in control. We never got control of Equitable PCI. GSIS and SSS had 2/3 of the shares. We had the greater share than the Gos. But the Gos had control...Equitable PCI issued no dividends at all; it was a losing thing.” – SSS

For the GSIS representative on company boards, the PGM Winston Garcia, his feisty and headstrong character is well known. While it is not normally part of Philippine company board culture for a board member to be outspoken, Garcia breaks this mould:

“With the character of PGM Garcia, he is very proactive. There are stories of him asserting GSIS’ ownership. I have sat on a number of board meetings and there are the usual board squabbles. He will not let a decision pass if he disagrees with it. He will not sit back on the bench if he feels the decision is incorrect and he will assert his one seat. He will walk out of a board meeting if he felt the decisions were made contrary to his inclination [or GSIS’s interests].” – GSIS

Similarly, the SSS representative on company boards, then Commissioner De La Paz, also took a more active approach as a result:

“[SSS has a seat] on PLDT, Meralco, and SMC – De La Paz sits on those boards. She is very vocal because she sees her role as representing SSS...[but] most of the time we are passive investors.” – SSS interviewee

In a country that values smooth interpersonal relationships, the board conflict and drama over the Equitable PCI episode have ensured a more measured approach in future:

“It is not normal to tell a board to do certain acts [in this country]. It will normally take a strong PGM to speak for the system [GSIS]. The board of trustees dictate [actions] unless the PGM [does]. It is doubtful if the Board of Trustees will enter so proactively [again in corporations]. There is not a policy adopted by the board on [being proactive].”-GSIS

For the time being, the Equitable PCI experience has shown the limited experience of institutional investor activism in the country. Nevertheless, both GSIS and SSS can - political will and non-interference notwithstanding - may contribute to more effective corporate governance in public companies and towards the economic development in the country when they are allowed to run independently. (World Bank 1995: iv)

8.10 Public Sector Boards

In contrast to a board of directors in the private sector who are elected by the majority shareholder/s, all three government financial institutions in this chapter have board members who are directly appointed by the President. The three boards face a different set of challenges compared to their private sector counterparts where the appointer is the owner (who is usually the Chairman) in the private sector; the appointer in the public sector is the President. With this appointment come political considerations whereas in the private sector, family considerations are foremost. This section looks at board appointments, board removals and the particularities of the presidential appointment system.

8.10.1 Presidential Appointments

As outlined earlier in this chapter on Politicisation, the country’s President has extensive powers of appointment. Thus, for many government institutions, the powers of appointment are set out in both the Constitution and the Act of the organisation. The following table sets out excerpts from the GSIS Act (also known as Republic Act

No.8291)¹⁰⁰ and the Social Security Act (also known as the Republic Act No.8282)¹⁰¹ containing explicit references and sections of oversight and powers of the President of the Republic over both organisations:

Table 36: Presidential Powers in the GSIS and SSS Acts

GSIS Act (1997) or Republic Act No. 8291	SSS Act (1997) or Republic Act No. 8282
<p>Section 9: Computation of Basic Monthly Pension</p> <p>2. b) The basic monthly pension may be adjusted upon the recommendation of the President and General Manager of the GSIS and approved by the President of the Philippines...</p> <p>Section 35: Deposits and Disbursements ...A maximum expense loading of twelve percent (12%) of the yearly revenues from all sources may be disbursed for administrative and operational expenses except as may be otherwise approved by the President of the Philippines on the basis of actuarial and management studies.</p> <p>Section 41: Powers and Functions of the GSIS</p> <p>r) to submit annually, not later than June 30, a public report to the President of the Philippines and the Congress of the Philippines regarding its activities in the administration and enforcement of this Act during the preceding year...</p> <p>Section 42: The Board of Trustees The corporate powers and functions of the GSIS shall be vested in and exercised by the Board of Trustees composed of the President and General Manager of the GSIS and eight (8) other members to be appointed by the President of the Philippines</p>	<p>Section 3: a): [the organisation to be]...controlled by a Social Security Commission composed of</p> <ol style="list-style-type: none"> 1. Secretary of Labour and Employment or undersecretary 2. SSS president 3. 7 appointed members : <ol style="list-style-type: none"> a. 3 represented by workers group; at least 1 of whom shall be a woman; b. 3 from the employers' group, at least 1 of whom shall be a woman c. 1 from the general public whose representative shall have adequate knowledge and experience regarding social security, appointed by the President. <p>The six members representing workers and employers shall be chosen from among the nominees of workers' and employers' organisations. The Chairman of the Commission shall be designated by the President of the Philippines from among its members.</p> <p>b) The SSS President shall be appointed by the President of the Philippines and shall receive a salary to be fixed by the Commission with the approval of the President of the Philippines, payable from the funds of the SSS.</p> <p>Section 4: Powers, duties of Commission and SSS; approval needed from the</p>

¹⁰⁰ "Republic Act No.8291: An Act amending Presidential Decree No.1146, as amended, expanding, and increasing the coverage and benefits of the Government Service Insurance System, instituting reforms therein and for other purposes." From the Global Legal Information Network (2009) Republic Act No. 8291 <http://www.glin.gov/view.action?glinID=59905> accessed 26 April 2009; The link allows a PDF file containing a scan of the Official Gazette; an HTML version of the Act exists at <http://www.chanrobles.com/legal4gsis.htm> hosted by the Chan Robles and Associates Law Firm accessed 29 April 2009

¹⁰¹ Social Security Act of 1997 or Republic Act 8282 (2006)

<p>Section 44: Appointment, Qualifications, and Compensation of the President and General Manager and of other Personnel The President and General Manager of the GSIS shall be its Chief Executive Officer and shall be appointed by the President of the Philippines.</p> <p>Section 48: Powers of Insurance Commission The Insurance Commissioner or his authorized representatives shall make an examination of financial condition and methods of transacting business of the GSIS at least once every three (3) years and the report of said examination shall be submitted to the Board of Trustees and copies thereof be furnished the Office of the President of the Philippines and the two houses of the Congress of the Philippines within five (5) days after the close of examination.</p>	<p>President</p> <ul style="list-style-type: none"> a) The Commission <ul style="list-style-type: none"> 1) To adopt, amend and rescind, subject to the approval of the President of the Philippines, such rules and regulations as may be necessary to carry out provisions and purposes of this Act 2) To establish a provident fund...subject to such rules and regulations as it may promulgate and approved by the President of the Philippines 6) To compromise or release, in whole or in part, any interest, penalty or any civil liability to SSS in connection with the investments authorised under Section 26...as it may prescribe and approved by the President of the Philippines... b) Social Security System To submit annually not later than April 30, a public report to the President of the Philippines and to the Congress of the Philippines covering its activities in the administration and enforcement of this Act during the preceding year including information and recommendations on broad policies for the development and perfection of the program of the SSS.
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For both organisations, the powers of presidential appointment with regard to the composition (or membership) of the board and chief executive are well-articulated in Sections 42 and 44 of the GSIS Act and Section 3 of the SSS Act. An operational power of the President is referred to in Section 9 of the GSIS Act while the Insurance Commission is also involved in the financial examination of the organisation in Section 48 of the same act. With regards to reporting, both GSIS and SSS are required to make an annual report to the President and Congress of the Philippines as set out in Section 41 for the former and Section 4 (6) for the latter.

The issues of presidential appointees also cover the assessment of who can be the ideal director on a public sector board. Good corporate governance practice suggests that having a director who is independent in mind and in action would best serve the interests of the organisation s/he is representing:

“For Philippine GOCCs, we have [attended corporate governance] seminars before, but there is a basic problem - how can we have independent directors if everybody gets appointed by the country’s president? The President has enormous power to relative appointments and the president does recognise that there must be good corporate governance. The President believes good corporate governance must prevail be they public, government-owned corporations or else. It is difficult to change the culture but we have to start.” – public sector

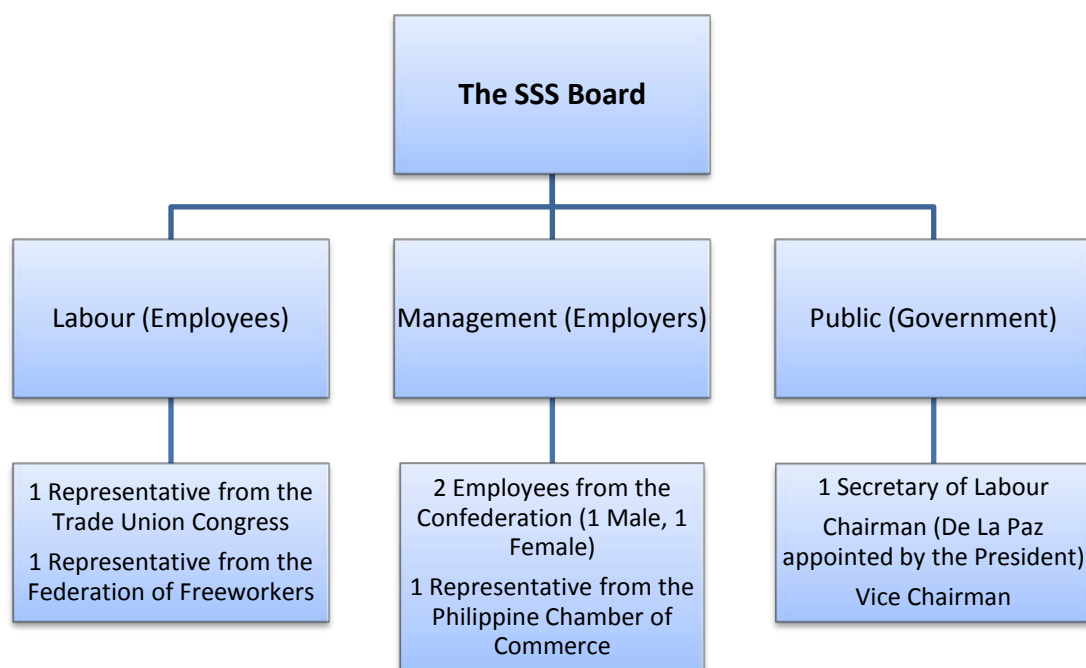
The current presidential appointment system is disadvantageous to the pension funds as the structure impairs their “authority and independence”. (World Bank 1995: 19-20)

8.10.2 Board Members

The board of trustees at GSIS comprise of 10 members. The length of appointment depends on a trustee’s ability to remain on side with the current administration. The trustees represent different government bodies. There are only two permanent trustees on the GSIS board.

For SSS, the board of directors comprise of 9 members. As a government owned entity dealing with private sector employees, three board members represent each of the three stakeholders groups: employees, employers and government. As covered in the SSS charter, it is a tripartite, stakeholder representative board as seen in the following chart:

Figure 42: The SSS Stakeholder Board in 2007



The charter was also amended in 1997 to cover gender representation stating that at least 1 representative from labour should be a woman and at least 1 representative from the private sector (or management) should be a woman. The SSS directors have fixed terms of three years' duration that may be renewed. While the appointments are made by the President, the directors must be recommended by each stakeholder group they represent.

The same procedure is in place at the DBP. Directors are appointed through the Presidential Management Committee (PMC) based at Malacañang Palace. The PMC has a shortlist of potential board directors that recommends and screens possible appointees. Candidates are filtered by taking into consideration the performance of the person, qualifications and ensuring they have no criminal history. The DBP board has 9 members and in 2007, the Vice Chairman was also the President of the Bank. The tripartite nature of public sector boards has also come under criticism. Representing a broad range of stakeholder groups may render an unyielding, under-performing board prone to political risk (Ghosh 2006: 136).

Finally it is worth mentioning that issues of ownership and representation will continuously come up with any privatisation of Philippine government owned entities. Thus, much consideration and expectation is invested in presidential appointments on a

public sector board. The departure of a presidential appointee before the end of one's term tends to receive wide coverage as the following section relates.

8.10.3 Removal of Board Members

The political nature of these appointments has come under scrutiny as political appointments tend to bring its own problems such as the circumstances and the terms of their appointment, their political backers or sponsors and so forth.

Several former trustees of the GSIS board were removed due to incidences that reflected poorly on the organisation. One was Jocelyn Bolante, accused of embezzlement (Alberto 2008) and at least two others were removed because they were associated with the political opponents of the President.¹⁰² The removal of a public sector board member usually receives wide media coverage:

“[Directors] who get media mileage [about their resignation] are usually on the boards of government corporations. There is a great deal of media coverage there.” – ICD

In Philippine corporate governance, the public sector is ahead of the private sector in the frank disclosure of board director resignations. While private sector board director resignations are normally prefaced by ‘health reasons’, the reasons for public sector director dismissals or resignations are normally well-publicised. In some cases, the media is told in advance of the removal of the public sector director which may come as a surprise to the office-holder (see Case Study of De La Paz's removal in this chapter; and the removal of the BIR commissioner in the next chapter).

The following case study relates the departure of then SSS Commissioner, an experience not too uncommon among presidential appointees:

Text Box 11: Removal of SSS Commissioner Corazon De La Paz

The power to appoint or dismiss the executive head of the SSS by the President was exercised in the lightning removal in 2008 of the well-regarded, and highly esteemed SSS Commissioner, Corazon De La Paz. Like so many other presidential appointees, De La Paz served at the pleasure of the President - and removed at her displeasure:

“De La Paz said that she only learned of Malacañang's move when she received a call from Finance Secretary Margarito Teves on Tuesday night while she was

¹⁰² According to a well-informed source, two trustees close to Senators who were critical of the President were removed.

attending a business meeting in Kuala Lumpur, Malaysia. He called me up to tell me about the decision,” she said. De La Paz acknowledged that politics figured in her departure from the state pension fund for workers in the private sector, but said that she submitted her resignation to Malacañang last month. “If you are in government, there will always be politics,” she said in a telephone interview. (Lucas 2008)

Her departure was not well-anticipated. During my fieldwork there was the widely held expectation that she would last until at least the next president, given the well-regarded career she had:

“Our chairman, De La Paz, serves at the pleasure of the president so she’ll have 3 more years as GMA’s term ends in 2010...Ms Dela Paz has a good reputation in the private sector. [She is known for having] integrity. She wasn’t chair of [PriceWaterhouseCoopers] and the audit committee for nothing. She has a clean image in industry. She sits on [other company boards] chairing their audit committees. These committees take advantage of her background.” – SSS

Indeed, her removal was widely seen as another political move; a move which reflected less on De La Paz’s ability but rather more on the thwarted intentions of her critics:

“There were just too many issues,” the [Malacañang] official said, referring to De La Paz’s dealings with anti-administration groups and organisations. “I think she’s too closely identified with the Makati Business Club and even the Black and White Movement...Bayan Muna Rep. Teodoro “Teddy” Casiño called the SSS appointment a bribe to keep [succeeding SSS Commissioner Romulo] Neri silent on the controversies hounding the Arroyo administration, including the National Broadband Network deal between the Philippine government and China’s ZTE Corp. This assures Arroyo she has an SSS head that will look the other way and keep silent as she and her minions plunder the pension funds of the private sector workers,” said Casiño.”(Lucas 2008)

Her insistence on standing up for the purposes and responsibilities for which the organisation stood for was another factor:

“When they [politicians] ask me, I answer them the truth, I’m usually direct. So I said no. I have a very strict interpretation of the SSS regulations, and I have been trained for many years as an auditor. I speak my mind on what [type of funding] cannot be allowed,” De La Paz-Bernardo explains without going into detail about any specific incidents, which have caused the tensions between her and some of the President’s people. “I was just being true to myself to protect the funds of the SSS members.” She adds that even the agency’s commissioners supported her in rejecting those requests. Eventually, she heard some Palace officials were “not happy” with her. She also had a feeling that she would soon be asked to resign. “I knew they were going to do it, and there were many who said there were several politicians who didn’t make it in the last elections who wanted to sit at SSS. So even if they didn’t ask me to resign, I knew they would eventually.”(Arnaldo 2008)

The departure of De La Paz from SSS was keenly felt with one employee stating “She looked after us as a mother would look after her own children.”(GMANews.TV 2008) For De La Paz, her reputation and integrity is well-known nationally and internationally. While she may not have found political favour in her home country, her outstanding

career and contribution to her profession is widely recognised. In 2007, the government licensing agency for professionals, the Professional Regulation Commission bestowed upon De La Paz “Outstanding Professional of the Year” in the field of accountancy citing her “outstanding achievement and high degree of professional competence in the field of accountancy exemplified by her excellent stewardship of the SSS as president and CEO.” (Manila Standard 2007)

De La Paz achieved many firsts in her career - as a woman and as a Philippine national – such as becoming the first female partner of Price Waterhouse International and board member of the Price Waterhouse World Board. In recognition of her outstanding career, the International Social Security Association (ISSA) re-elected De La Paz for a second appointment as ISSA president. De La Paz is the first woman and first non-European president of ISSA. (ISSA 2009)

To commemorate May Day 2008 in the country, an open letter to then President Macapagal-Arroyo signed by 61 former public officials who at various times in their careers were appointed or removed by the chief executive of the country – “victims of bad governance” - as the current system allows. The letter was prompted by the NBN issue (see Chapter 10) and the list of signatories (and the government organisations they once represented) is testament to the negative effects of the extensive appointment powers in the hands of the country’s chief executive. (Newsbreak 2008)

8.10.4 Views on the Presidential Appointment System

The fickleness of the presidential appointment system makes most government organisations highly politicised creating a great deal of uncertainty. Uncertainty leads to instability and reinforces the lack of trust in government. Long-term relationships are difficult to sustain with ministers (or secretaries) who serve and are dismissed at the whim of a president:

“It’s like a revolving door. Secretaries come and go.” -private sector 1

For a president keen to ensure the loyalty of his/her departmental heads, their allegiance to the incumbent rather than their competencies tend to play a greater role:

“If you’re against the administration, you are removed.” – public sector 1

“The [agency] is an interesting organisation. It is a regulatory authority but political in the way that they operate, as most things are here.” – private sector 2

For many of my private sector interviewees, the revolving door of presidential appointments is a challenge. It raises the question of skills and competence:

“There’s a tendency to put cabinet secretaries or ministers of GOCCs [government owned and controlled corporations] to be placed as directors on [their boards] as senior political appointees. This sends a strong signal. Change it. The cabinet secretary has no time, s/he is swamped, s/he has no breaks. [They] don’t attend meetings. The governance system doesn’t provide that continuity. [What is needed are directors who are] educated professionally for the appropriate [role].” – private sector 3

“The Philippines simply doesn’t change as there are many rules such as a President with political appointments. The people in government do not realise their position is not of directors, but more of trustees.” – private sector 4

There is also a waste of resources every time there is a new appointment

“There is not a strong civil system here unlike the West. [With each new presidential administration] there are new heads of agencies appointed by every new president. The sustainability and stability priorities [of the organisation] are affected. Resources are limited in this country. When new heads come in, it is always an issue of competence. With every change over you don’t see much significant change in implementing programs. New sets of initiatives are set up. At the end of the day, there is not much accomplishment and a wasteful use of resources.” – private sector 5

Behind each dismissal of a presidential appointee is a story of politics and how well connected a person or group is to the President:

“The previous Commissioner was kicked out. He was asked to resign as he had alienated quite a few people and [so he was] forced out. There is a lot of politics behind it.” – private sector 6

Not surprisingly there are calls for reforms to the presidential appointment system with more professional appointees: For the time being, altering the presidential power of appointment over government institutions, according to one is “politically risky” and the more politically safe route is addressing issues of operational efficiency. In the

Philippines, the political environment is such that public sector organisations are minimally buffered from various vested interests. For the near future, dealing with highly politicised presidential appointments and appointees are a facet of doing business in the Philippines.

8.10.5 Board-Management Issues

Aside from the sensitive issues of political appointments, operationally-wise, the role of the public sector board is similar to the private sector board – the board oversees management. Reporting, strategic planning, performance and information disclosure are cited by the three organisations in this chapter as board-management issues.

In every board meeting of the DBP, financial reporting, and accounting reporting of the bank's financial performance are presented every month. For other matters, there's a management committee composed of senior officers of the bank which meets every week. Departments within DBP that have different issues attend the management committee meeting. There is a regular reporting system at DBP. The board also schedules strategic planning meetings with management. This is done in-house held annually in October.

In 2007, SSS had a very active board overseeing the management by way of performance reviews:

“The current commission scrutinises all of our contracts and budgets. The current board specifies quarterly performance reviews against the targets set at the beginning of the year” – SSS

The SSS board also requires quarterly references from management on accomplishments made at a departmental level. These references form the basis of the quarterly performance targets for the year. This process has seen a lot of board vetoes of management proposals.

Echoing the experience of any board with its meetings with management, information held or being withheld by management and trying to mitigate this situation is one the GSIS board faces:

“Like any other big corporation, the board doesn’t get to know everything from the ground. Management knows everything - they can react or initiate necessary changes. [They can] come out with a better policy or improve the system.” – GSIS

In this regard, the issues mentioned above are not so dissimilar to one faced by any board – be they public or private.

8.10.6 Public Sector Board Remuneration

Remuneration in the public sector is unattractive compared to private sector rates. The joint 2003 World Bank-ADB report pointed out the compensation regime in the public sector does not attract nor retain the best or brightest talent (2003:107). The lower rates of remuneration hinder the hiring and retainment of highly-qualified directors. (Ghosh 2006: 136)

One interviewee spoke about his experience of mitigating the political risk of interference while he was a director on a government board that oversaw the privatisation of a government asset:

“...we made sure any employee [we hired was] competent. [We made sure] there was no politically [sponsored person] who could come in for a position. [The board] made sure we didn’t go to the government or ask politicians for money from them for our budget. [We had to] generate cash flow internally. Had we asked for money from [the politicians] for our budget, they would want 1 or 2 employees [they were sponsoring] at the organisation.” – private sector 1

In an exchange, the same interviewee and I discussed the old adage of how power corrupts and how absolute power corrupted absolutely. He mused:

“How can one ensure that people who get in are not immoral? People in government [can become] immoral with so much power.”-private sector 2

Nevertheless, people who enter the public service and especially those who join public sector boards do so with a higher sense of duty. Directors who are not career bureaucrats join government boards because they have had a successful working life in the private sector and are now able to transfer their wisdom, experience and knowledge to the

public sector. As former Australian Prime Minister John Howard said in his farewell speech after his 2007 election defeat:

“Public service is the greatest form of service that can come one's way in life.”(Eastley 2007)

In a 2009 corporate governance symposium held in Sydney, Trevor Robertson, an executive at the Australian infrastructure company Downer EDI presented a summary of his postgraduate research on a comparative study of corporate governance in the public and private sectors. The table from this presentation is reduced below:

Table 37: Remuneration in the Government Sector and the Private Sector (Robertson 2009)

Government Sector	Private Sector
Set by Government: <ul style="list-style-type: none"> - Shareholder Ministers (Secretaries) - Departments - Board -> Remuneration Committee 	Market-Based: <ul style="list-style-type: none"> - Board Remuneration Committee - Shareholder Approval - Market Data – Sources vary (validity)
Intangibles: <ul style="list-style-type: none"> - Sense of Public Duty - Non-Executive Director (NED) experience 	Options: for the future?
Rewards: <ul style="list-style-type: none"> - Renewal of appointment -> set terms 	Salary Sacrifice for Shares: <ul style="list-style-type: none"> - Longer term incentives - Material - Escrow >term of appointment
Performance: <ul style="list-style-type: none"> - Board / Chairman - Government / Minister 	Performance linked: <ul style="list-style-type: none"> - Company performance - Board performance - Shareholder

In the Australian government sector, the remuneration is set out by the government with input from the Minister (or Secretary in the Philippine context), the governmental department where the board is located, and the remuneration committee. Private sector remuneration is market-based with approval needed from shareholders. For a director of a public sector board, joining a government authority is motivated by a sense of public duty and accumulating non-executive director experience (and increasing one's network) which may be welcomed if one then seeks to join a private sector board.

It is advisable that before joining a Philippine public sector board one must be independently wealthy, not politically sponsored, disconnected and depoliticised from those who seek to politicise the government institution. The reasoning behind this was captured by Hutchcroft where he relates the advice dispensed by the then head of the Philippine Bank of Commerce to his protégé, a governor of the Central Bank of the Philippines, Jose Fernandez:

“Don Pepe Cojuangco of the Philippine Bank of Commerce told Fernandez that he was ‘too young and too poor to be in government service’ and should join it only when he was ‘old and rich.’ In fact, he was being advised of the wisest path to power within a patrimonial oligarchic state: join the bureaucracy after developing a strong independent base outside the state apparatus.” (Hutchcroft 1998: 172)

This advice remains invaluable for potential members of Philippine public sector boards.

8.11 Closing Remarks

This chapter extensively looked at the experience of three government financial institutions in the heavily politicised environment of the Philippines. All three have experienced the harsh realities of decisions made under undue and partial influence. In this sense, it is almost a miracle that corporate governance in some form or other has entered the vocabulary and practice of these organisations despite the lack of transparency, lack of accountability and opaque disclosure.

Politicisation of government institutions, especially those dealing with the financial aspects of government, can expect interference. Such interference usually has a detrimental effect on the country. Interference from the government executive must be held in check to curb the temptation to capture the government financial institutions. The bureaucracy needs to be strengthened and must be treated not as an extension of the executive or expression of presidential power but as representing autonomous functions to serve all, and not just a select few, citizens of the country.

Until the problems and consequences of politicisation are widely recognised by the political representatives of the country, this problem will continue to affect the whole of government in the foreseeable future. Until such fundamental attitudes are made, the

damaging effects of politicisation will continue to blight and hinder the development of the country.

CHAPTER 9: CORRUPTION

Corruption was not originally in the scope of my research when I first started this journey. However, it became clear after my initial interviews that corruption is currently part and parcel of the business environment in the Philippines. Appendix 9 contains a table of corruption nodes analysed in NVivo. Unlike other chapters, the contents here have resulted from the inductive method of inquiry conducted during my research. Paraphrasing Sitglitz's 2002 book, corruption and its disincentives is the main theme of this chapter and explores the following question:

What are the effects of corruption in impacting the implementation of corporate governance reforms in the Philippines and society at large?

Corporate governance must be seen in the prism of the business environment. In this sense, corruption is part of the business environment and it can clash with the governance tenets of transparency, accountability and disclosure. Can an organisation disclose certain information without the data being used against them by certain parties? To what extent can a company be transparent without compromising the viability of the business? To whom is a business ultimately accountable – its financial shareholders or political masters?

Reading the newspapers or watching the numerous news programs on free to air television, the theme of corruption was ever present. “*Kurakot*” (corruption) of high level officials and their business counterparts was reported daily in the news media.

This chapter describes all that is ill, and all that is wrong with a country riddled with corruption and the main areas and sources of corrupt activity are explored.

Corruption is endemic and wholly affected the private sector representatives I interviewed. Corruption does not distinguish between a business that is big or small; listed or unlisted; local or foreign; ethnic Filipino or not.

Corruption breeds resentment and distaste amongst the populace. Corruption brings an unfair advantage to those who are politically well-connected. Corruption reduces confidence. Corruption makes a mockery of laws and rules that govern behaviour. Corruption discourages people to be honest and transparent. Corruption is a cycle that

can be broken and must break for the country to progress. Corruption is a major socio-psychological contributor to the ongoing poverty to the country and the flight of Filipinos to seek better lives elsewhere.

9.1 Types of Corruption

The following types of corruption and corrupt behaviour were mentioned by my interviewees:

- Bribery: “It’s sensitive, bribery. In Filipino culture, you have to know somebody to be facilitated.” – public sector 1
- Extortion: “The other corruption is extortion. If one wants to build up a place, all sorts of permits are required. In my local government unit, every step of the way is an act of extortion. You don’t pay the permit, you don’t get in. These are complicated issues. The Ayala CEO is right; you can’t grow big using ethical standards.” – private sector 1
- Favouritism or Reciprocity¹⁰³: “People want to stay in power. Favouritism, it’s one-sided. I scratch your back, you scratch my back. It’s corruption – being one of the most corrupt countries.” – private sector 2
- Fraud/Estafa¹⁰⁴: “Business fraud is a strategy by us to manage our risk. When we tell our clients to implement control, we are telling them to prevent the risk of fraud from happening...the perception is we can find all types of fraud but that may not be the case. The longer term strategy is to manage business risks in firms, and introduce transparency” - private sector 3
- Influence – peddling; undue “Marcos used to make such a living out of influence peddling...it made business out of politics. The politicians created a vital commodity and created incentives for rent-seeking.” – private sector 4

¹⁰³ A good discussion on the positive and negative aspects of gifts and reciprocity can be found in Komter (2007) As Frans de Waal (1996:136) observes: ‘Reciprocity can exist without morality; there can be no morality without reciprocity.’ Indeed, in the case of the Australian mining company, BHP Billiton, the acceptance of what constitutes (in)appropriate gifts is mentioned in their 2004 and 2008 Guides to Business Conduct: “BHP Billiton employees must exercise the utmost care when offering or accepting gifts and hospitality in order to protect their reputation and BHP Billiton’s reputation against allegations of improper behaviour and to ensure that bribery laws are not breached.” and “A golden rule here is disclosure. Ensuring your supervisor is aware of all gifts of any significance ensures transparency and avoids any suggestion of conflict of interest.” (2004: 40, 42)

¹⁰⁴ In the Philippines, there is a type of fraud known as estafa (swindling) which is the intention to defraud (Cardinoza 2007). For a major discussion of estafa, see Reyes (1998).

- Kickbacks: “Corruption is pervasive not only in the public sector but also in the private sector. Doing business with private corporations, you also have to give kickbacks. Not to all of them but a number. For example, the [sector my business is in] is a duopoly. There is no proper regulation for the regulatory authorities [to oversee it]. For purchasing they ask you for kickbacks. Even banking executives ask for kickbacks for giving loans. That’s the environment.” – private sector 5
- Rent-seeking: “The history of the Philippines is bound in rent-seeking. It is a weak state controlled and manipulated by rent-seeking elites that would lean on government so they can extract monopoly and profits...the culture of rent-seeking is to capture politicians – to capture the decision making so you’re not accountable.” –private sector 6

These forms of corruption have a detrimental effect on the effective functioning of commerce in the country.

9.2 Corruption in East Asia

Several interviewees noted the incidences of corruption and corrupt behaviour in the region so the Philippines is not alone in dealing with this problem:

“In Indonesia, if you want to have a press conference with the media, you have to give a backpack of goods to meet with them. Then they’d turn up. In a court case, you pay money upfront to file a case. How do you do business otherwise?” – private sector 1

However, with the downfall of Marcos, corruption in the Philippines has now taken a more arbitrary form. With the loss of the central figure, corruption has now become more unpredictable and arbitrary as one of my interviewees pointed out:

“[We have become] one of the most corrupt countries. [Even if we aren’t], the perception is there. Corruption has gotten worse. [Under Marcos] the corruption was already scandalous – you had a tyrant there, it was focused on him and his cronies. [But after his downfall] you uncork the tyrant, you uncork the bottle and all these little tyrants [have] come out.”-private sector 2

Similarly, the unpredictability of corruption has made doing business particularly difficult in the Philippines:

“In Indonesia and Vietnam, when you have to be in a position to bribe someone, what’s delivered is delivered. Here, what’s supposed to be delivered is not delivered. You can’t trust the person you’ve bribed.” – private sector 1

As payment requests seem never-ending in the country, the question of corruption’s unpredictability in the country was a factor this interviewee noted:

“Is it a question of organisation? Koreans are well organised. Many things happen here. What happens a lot here is at the time they make the commitment, something happens afterwards. Something they did not anticipate or another bribe that has to be paid.”-private sector 3

While corruption is seen as part of the hazards of doing business in the region its unpredictable nature in the Philippines makes it doubly difficult undermining general business confidence. The next sections discuss the presence and mitigation of the two types of corruption – low level and grand or systemic corruption (see Chapter 2 Literature Review).

9.3. Low-level Opportunistic Pay-Offs

This section follows from Chapter 2 (Literature Review) figure of Rose-Ackerman’s 4 categories of low-level corruption: scarce public benefits; benefits to qualified but not monitored; delays in bureaucratic process, and imposition on costs for government programs.

9.3.1 Scarce Public Benefits

With regards to scarce public benefits in countering the presence of low-level opportunistic pay offs in the country the Makati Business Club, with the Ateneo School of Government, has taken a novel approach in monitoring the delivery of educational textbooks to schools in the country. For some years, school textbooks “were not being delivered as they were accounted for. Schools didn’t receive the books.” To address this problem, they requested that clubs of boys’ scouts count the ‘ghost delivery’ of textbooks. The boys’ scouts would watch the delivery and raise alarms if the books weren’t being delivered. Under the auspices of eagle-eyed scouts, the ghost delivery is down to zero and the prices of the books have come down from P90 to P46. As corruption deals at the basic level with issues of supply and demand, removing the

discretion from the official channels have allowed efficiency to reign again. Bypassing associated complexities of the simple delivery of textbooks have allowed, for at least this part of the distribution process in a core sector, to reach the audience they were intended for.

9.3.2 Lack of Monitoring of Benefits to the Qualified and Unqualified

Public service officers who have access to sensitive information such as personal records render them a certain amount of leverage over a client:

“There’s a culture of service here. There may be some isolated cases such as petty graft, and grease money to speed up the transaction. On bribery [it’s present with those who deal with] records. You are dealing with personal records. Some have access to the database. There might be a case of where a person that has not received a loan yet and that information would be useful to a bank. [We are trying to address this with a] charter [and code of ethics] that covers confidentiality and sensitive issues. If you have access to a record, you would know how [much] they have.” – public sector

The lack of monitoring or control over the officers or gatekeepers of information allows this form of pay-off to proliferate.

9.3.3 Delays in the Bureaucratic Process or Queues

This level of discretionary power amongst public officials is quite common. One source described how renewing his driver’s licence at a government agency became eventful. When he arrived he saw two queues. People in the queues were going back and forth from one queue to another. Once he arrived at the top of the queue, he realised the reason for this organised chaos: people were bargaining with each official about the payment to renew their licence. My source participated in this exchange and haggled with one official and the other. After an hour, he realised the opportunity cost – he haggled to save P500 to renew his licence.

One public sector interviewee stated there are some “people [in the organisation] who do not want to queue up for services... [so this is a] governance issue we want to take seriously on this instance of graft and bribery. While there’s a law (the Republic Act) on

graft and corruption, [we want to operationalise the law] so it can be specifically tackled here.”

For a private sector interviewee, he reflects how it was more efficient in times past:

“I’m a lawyer so I visit government offices. When I was a young lawyer 30 years ago, if you get your papers done, it gets through. These days, if you go there, even low-level government officials try to get some donations from you for their summer outing, an office picnic or other.”-private sector 1

For another private sector interviewee, he related that as part of their contract, they had to build new offices for the regulatory authority which was overseeing them. There was some discussion over the bathrooms of the public officials (a high level public official usually has his/her private bathroom) - after due consideration the company decided to turn down requests for more expensive plumbing fixtures.

9.3.4 Costs of Government Programs

A generation or two ago, the Philippines was an exporter of rice. Today, the country is the world’s largest importer of rice. As a forerunner to the food crisis that affected the country in late 2007, Lalaban (2007) reported how a “big volume of government rice being distributed by the National Food Authority (NFA) through the so-called *Bigasang Bayan* (rice for the people) end up in black markets ...[as] some of the agency’s personnel connived with unscrupulous rice traders in diverting government rice to the black market...Favoured operators who have contacts inside the NFA could buy as much as 1,000 bags of rice but at a higher price. Rice are re-milled by the buyers and sold at much higher price.”

One of the country’s tourist attractions are cascading rice terraces that rise on the side of steep mountains. These terraces have been tilled and toiled for thousands of years and are a symbol of an agrarian society’s triumph over a landscape famed for annual natural disasters. Labour cost is not an issue - but access to land is. Formerly rice paddy fields have been replaced with the increasing encroachment of commerce. The Philippines has the climate for rice production with its tropical climate and its seasonal extremes. Water is not a problem like in Australia where rice production is done on an industrial scale. So what ails rice production in the country? What are the operational reasons that have

made for such a dire outcome? Are there issues of procurement? Processes? Lack of investment? Subsidies? Which groups of people are benefiting in the system from production to procurement?

The worldwide food crisis badly affected developing countries in late 2007 due to a variety of factors (such as increased food prices with speculation on food commodities as possible substitute for fossil fuels) that created the perfect economic storm. According to the ADB, there was a combination of internal and external forces to the food crisis in the country. For the country, the food crisis highlighted its vulnerability as: “The Philippines is the world’s largest importer of rice, buying 10–15% of its consumption needs from abroad...The import bill for rice in the first half of 2008 was \$858M, nearly four times as high as the prior-year period.” (ADB 2008:178)

The Philippines saw food or rice riots and the country was one of the worst hit nations. The people rioted because of food insecurity (BBC 2008) Compounding low-level corruption contributes to the continued hunger and poverty of the populace as it distorts the efficient distribution, in this case, of staple foods. This in turn creates an unstable, divided society. The corrosive effects of corruption especially its impact on society was touched upon by then Dutch Ambassador to the Philippines, Robert Vornis, speaking at the 1997 Institute of Corporate Directors Annual dinner:

“The response from the World Bank is there is no sustainability and substantial economic growth, poverty reduction in countries with wealth if there is institutional and rampant corruption. Rampant corruption decreases public trust which erodes the foundations of society. The very fabric of society is threatened [by corruption] which leads to the collapse of societies. This applies to both public and private sectors hence the partnership with the private sector. Good corporate governance becomes in essence futile, if confronted by weak public governance.” –Dutch Ambassador Vornis, ICD Annual Dinner, May 30, Shangri-La Hotel, Makati

As one of my interviewees pointed out:

“There are no rules when you are hungry.”

Corruption’s impact severely affects the most vulnerable in the country.

9.4 Grand or Systemic Corruption

The following sections look at how grand corruption permeates through Philippine society as exemplified by:

1. The lack of confidence in the revenue-generating branches of the public sector
2. The lack of confidence in the judiciary
3. The dismay and lack of trust in the electoral system
4. The lack of transparency in government contract bidding

9.4.1 The Revenue-Generating Agencies

“Corruption in the government’s two major revenue agencies, the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC), has encouraged rampant evasion of personal and corporate income taxes. Corruption usually takes place during annual tax audits of companies by BIR examiners. The opportunities for corruption present themselves when companies are found to be cheating on taxes; some BIR examiners offer to settle for a lower tax assessment in exchange for a bribe. Efforts to stamp out corruption in these agencies have had only limited success.” (EIU 2008b)

Throughout my four months in Manila, time and time again incidences in the bureaux of customs and revenue came up in my interviews and the popular media. As the main revenue generating arms of government, these two bureaux are the manifestation of corruption in the country. I never sought to interview these two bureaux as they do not regulate corporate governance in the country (although one Department of Finance agency, the Insurance Commission, does regulate corporate governance). However, unprompted, my interviewees would speak about their dealings with both bureaux impressing upon me how important they are in the (in)efficient functioning of commerce in the country. A decade earlier, Hutchcroft noted the politicisation in both bureaux and their problems reflected poorly on the country:

“The amount of tax paid to the state is negotiable, and therefore highly dependent upon the current strength of one’s political connections.”(1998: 40)

Unfortunately, the passage of time has not significantly altered this perspective. Both

bureaux come under the purview of the Department of Finance¹⁰⁵ which has multiple responsibilities as the following figure shows:

Figure 43: Organisations under the umbrella of the Department of Finance



The Department of Finance (DoF) is organised with two main oversight responsibilities:

1) bureaux and 2) agencies and corporations

There are four bureaux under the DoF: internal revenue, customs, treasury and local government finance. Under agencies and corporations, the DoF has oversight over five: insurance, tax and tax appeals, deposits and export-import credit.

9.4.1.1 The Finance Secretary, Gary Teves

The Department of Finance head during my data collection was Margarito (Gary) Teves who like other departmental heads are appointed by, and serves at the pleasure of, the President of the Republic. The Secretary of Finance is a pivotal position in the Republic and paraphrasing Shakespeare, there is a feeling that uneasy lays the head that wears the mantle of Finance Secretary.

For Teves, he sees his highly critical role as analogous to the main disburser of family budget where he must address a great deal of conflict management over competing interests (Business Mirror 2007d). For the most problematic organisations under his tenure, one major issue is the reality of public service compensation set against a public servant's opportunism of profiting from the private sector:

¹⁰⁵ List of organisations under the Department of Finance
<http://www.dof.gov.ph/profile.asp?sec=bureaus> accessed 12 March 2009

“You’re a low-paid BIR examiner on P15,000-P20,000 a month and you examine [multi-billion peso] companies. A friend’s bookkeeper is a BIR examiner entrusted with [examining] 200 companies. 50 [companies] are doing very well and the examiner gets P5,000 each from each company or P250,000.” – private sector 1

"The bureaucracy is not properly compensated hence there are loopholes for corruption. There is a lack of discipline. It tempts the bureaucracy for corruption. Performance is neither appraised nor monitored. [Compensation is] not by meritocracy but done by seniority." – private sector 2

Teves takes the philosophical view on this:

“In terms of human dynamics in any organisation, there are other factors outside a lateral attrition law that will either provide the motivation or decrease the motivation. Unfortunately both bureaux, like most government agencies, the compensation package is still relatively low compared to their overall responsibility of generating resources for the government. If we were to do it the way we do it in the private sector, we would probably have a leaner organisation, provide better compensation and a better system of reward and penalty. But it takes time in an organisation called the government.”-Teves in Business Mirror (2007d)

Secretary Teves made an appearance at a monthly meeting of the Australia-New Zealand Chamber of Commerce (ANZCHAM) in Manila not so long after the sacking of the Internal Revenue Commissioner over a shortfall in the bureau’s tax collection target. The culture of personalisation in the Philippines is such that the departing Commissioner publicly made his feelings known over the terms of his removal:

“There are higher authorities in the government’s financial institutions who would like to wash their hands of responsibility for the dire consequences of their unrealistic, failed and bungled policies, and who look for a sacrificial lamb and a scapegoat to which they can assign the blame. So be it. Their time to answer for their failure and incompetence will also eventually come.”-Former BIR Chief Buñag in Labog-Javellana et al (2007)

However, from most accounts, the turnover of finance secretaries is such that Teves' tenure has been more successful than most. Since the end of the Marcos era, there have been 14 Finance Secretaries, each lasting an average of 18 months. Teves was coming up to his second year in 2007, an amazing feat, not repeated since another Finance Secretary, Bobby Ocampo in 2003. Teves is held in high esteem in his capacity as Secretary and is much admired for working within the constraints of the political pressure cooker of the country.¹⁰⁶ Congress, after all, "is a difficult institution, governed by people who will be asking what is in it for them." (ANZCHAM 2007)

For the most part, Teves is in favour of further economic liberalisation and privatisation: the latter to boost government revenues and for the former, to encourage long-term private sector competition:

"The government will move out of business that we believe can be best placed in private hands... [On privatisation], there are two major considerations for selling [government] assets. One is a policy move because we believe the government should not be in the business, that this business where in the government has a stake right now can be placed in better hands in the private sector. Number two is to generate revenues." (Business Mirror 2007d)

He is in favour of creating an environment where there is "openness, transparency and consistency." Questioned on the ownership limitations in key infrastructure sectors, he is also in favour of addressing them as the lack of infrastructure in the country is a main obstacle for further economic progress. (Business Mirror 2007d)

For the Department, the goal is "to reach long-term prosperity and improved welfare of the country and its people." (ANZCHAM 2007) While the Secretary has set out some noble and lofty goals for his Department's agenda, the following sections on the two problematic bureaux are descriptive accounts of the challenges he faces.

9.4.1.2 Bureau of Customs

Opportunism is present at the Customs Bureau according to one interviewee:

"I've had a PNP [Philippine National Police] General ring me up saying do this or

¹⁰⁶ At the ANZCHAM meeting it was made known the Secretary had high blood pressure for the preceding weeks over the kerfuffle. One observer noted, we now understand why the Secretary's hair has turned snow-white.

do that [in my operational capacity]; or Customs would ring me and say we have received a batch of products and ask whether I would like to receive a discounted price for it.” – private sector 1

It was not known what the price of refusal was.

The Customs Bureau also contributes to the unevenness of the playing field in the country according to another:

“...unethical companies can abuse the domestic market, especially if corruption in government regulatory agencies continues unabated. Smuggling or non-payment of correct taxes, undermining of labour laws are areas that can be exploited to gain against competitors.” – private sector 2

At the same time, political interference tends to undermine the operational effectiveness of the Bureau. In an incident when Customs tried to destroy luxury cars that were smuggled illegally into the country, some politicians swayed to prevent the bureau from completing this job:

“Quezon Representative Danilo Suarez said he wanted to bid for the Porsche. “But I don’t want to criticise the plan. I don’t want the President to get mad at me,” he said.”-Lim Ubac & Orejas (2007)

Was the Bureau’s ineptitude a sign of a deeper malaise?

“It has gotten worse since 2002. COMELEC has gotten worse. The BIR, Customs, the Philippine Military, DPWS, Telecoms, Agriculture...I don’t understand the meaning of [all of this corruption].” – private sector 3

For other public service organisations, it is with some relief that they are not as bad as Customs:

“We have enjoyed a reputation of being relatively clean compared with other national government agencies such as the BIR, Customs and GSIS. Basically it’s because of the [organisational] culture.” – public sector 1

However, one hopes the reality and perception gap can be addressed in the near future:

“I hope that in 5 years’ time corporate governance would be seen as another facet [of operating] in the country...At the Department of Justice there is a lot of corruption, [there are payments needed] to be made to the Bureau of Customs and [there is harassment] from the Bureau of Internal Revenue. These are all very basic reforms” – private sector 4

The revenue-generating arms of the Philippine government are bellwether indicators of the extent of corruption present in the country.

9.4.1.3 Bureau of Internal Revenue

If one could encapsulate what is wrong in the machinery of government, the exemplar would be the Bureau of Internal Revenue (BIR). Rightly or wrongly deserved as the whipping boy of the public service, the BIR is the black hole of lost hopes and causes. The BIR is akin to the canary in the mine, signalling any significant actions on reforming government organisations:

“...BIR organisational reforms would constitute a litmus test of ability and willingness to undertake core institutional reforms.” (World Bank and Asian Development Bank 2003: 110-111)

Like the infamous Goya painting of Saturn devouring his own son (Goya in Museo del Prado 2009) the Bureau eats idealistic people and spits out civil cynical servants. Recalling John F. Kennedy’s inaugural address dictum “ask not what your country can do for you, - ask what you can do for the country”¹⁰⁷, one is well-advised not to enter the BIR for fear of losing one’s patriotism:

“In the late 1980s, I knew this UP (University of the Philippines) fresh graduate who entered the BIR. She was full of enthusiasm. Five years later, I saw her. She had changed totally – the language, the body language.” – private sector 1

There is also a matter of institutionalised political patronage in the BIR. One interviewee recalled a visit he paid to the incumbent commissioner known for his reformist zeal. The then commissioner showed my interviewee his notebook which had a table: On the table contained the name of the BIR officials, the rank of the officials and the sponsor – the

¹⁰⁷ Kennedy, John F. (1961) Inaugural Address of President John F. Kennedy, January 20, Washington D.C.
<http://www.jfklibrary.org/Historical+Resources/Archives/Reference+Desk/Speeches/JFK/003POF03Inaugural01201961.htm> accessed 12 March 2009

political sponsor. This institutionalised corruption affects the effectiveness of the BIR to function well. This incident reinforces what Hutchcroft observed a decade earlier about the political patronage being systematically ingrained in the bureaucracy (1998:53). This political interference also places the BIR official in a bind:

“If a BIR official is faced with a tax case, someone would go to a certain politician and the politician would intercede. For the poor BIR official, he can’t render a fair judgment on the tax case.” – private sector 2

For taxpayers - organisations and individuals who do pay tax - the irony is by doing so, they are calling attention to their situation that they are capable of paying tax. Instead of pursuing tax evaders, having a ready list of willing taxpaying organisations and individuals make them easy targets for the BIR. (Remo 2007f) If one does not pay taxes, one does not get investigated as another complained to Secretary Teves at the ANZCHAM meeting:

“I operate a small business. There is total corruption in the BIR. It’s not something we talk about. With tax, only the BIR go after are those honest people who do pay. On the issue of tax collection, people who don’t pay tax don’t get investigated. We get targeted every year. It’s an uneven playing field. We work with other corporations and they don’t get taxed.” ANZCHAM (2007)

Similarly from an interviewee:

“Income tax is garbage in, garbage out. The grey markets believe that if they don’t report any income, they’re not traceable.” – private sector 3

When one does follow the rules of the BIR, one does not necessarily feel satisfied by the recognition:

“We won an award from the Bureau of Internal Revenue because of the way we pay tax – that is indicative of the structure for years. Nobody pays taxes. The system here is pork-barrelling. Every politician controls the money. They don’t invest in the electorate, the money disappears.” – private sector 4

One interviewee was more sympathetic. Value added tax or VAT was introduced because collecting income tax was such an obstacle. It was easier for the government to collect VAT:

“There has to be some bitter pills one has to take to go forward. We have taken them such as VAT. The public don’t understand the necessity of it since corruption is an issue.” – private sector 5

For public sector interviewees there is a skeptical attitude towards the BIR. According to a one interviewee, the BIR’s databases have not been harmonised with theirs for reasons of trust:

“There is slippage with the BIR. It is very slippery. We can’t find [the right company information] through the BIR. What the companies file with the BIR and we compare with the financial statements - they are different. You can’t own a vehicle if the value is less than P150,000 and you pay no less than P10,000 in tax. Sometimes what [companies] file with the BIR and what they submit to us, well they are different.” –public sector 1

The lack of progressive reforms within the Bureau signifies political unwillingness due to the task ahead of reforming the agency.

9.4.1.4 Reforms in the Bureaux?

So how does one reform the BIR and BOC? In the late 1970s there were plans to “reduce the corruption on the BIR” (Klitgaard 1988:13-97) but this dissipated as Marcos’ regime also became progressively oppressive and more corrupt. Thus, while local level institutional reforms can be implemented, they cannot be maintained unless they are part of a unified, current broader reform agenda. (Xin and Rudel 2004:297):

“We need to have complementary [corporate governance] reforms in the BIR, PSE, and other regulators. It cannot be just the private sector.” – private sector 1

In the post-dictatorship bureaux, there were moves towards decoupling the public sector pay in these two agencies. House Bill 5283 seeks to exempt employees in these two bureaux from the “Republic Act 6758 or Salary Standardisation Law” and instead use the tax and customs duties collected “as the basis for the salaries and bonuses of these agencies’ personnel.” (GMANews.TV 2008) While this bill did not find much support amongst the deputy commissioners of both agencies (Romero & Valdez 2009), the issue of adequate compensation commensurate with the supervisory and regulatory role of agents have been found wanting and such an issue needs to be addressed.

Applying existing laws was also subject pointed out in revenue collection:

“[We would like] the implementation of existing laws, uniform treatment and consistent application of laws and collection of taxes. There is only a small percentage of companies paying taxes. The government isn’t efficient in collecting and they only look at the visible companies [i.e. listed ones].” – private sector 1

Implementation has always been problematic for the Philippines. The reality is laws are enacted are rarely implemented in its entirety:

“Laws are not implemented properly and fairly. The only way is to have less government and make sure the rules are implemented. The less of [government in business], the better.” – private sector 2

According to former BSP Governor Singson, “We have good, beautiful rules, yet fail.” (Hutchcroft 1998:200) It does raise the question of usefulness of laws if they are rarely enforced and whether such laws should be removed to reflect the reality and inadequacy of legal enforcement.

For the long-term outlook, the wish of many interviewees is improving public sector governance to complement private sector governance reforms. A strong private sector needs a strong public sector and vice versa. One cannot run efficiently without the other.

9.4.2 The Judiciary

While the judiciary does not generate revenues (as it is an ongoing expense for a society ruled by law), the Philippine legal system is the cause of much distress from my interviewees. Where justice is not being applied in an impartial manner, the confidence in the institutional function of a country’s legal system is undermined.

Writing for Transparency International’s 2007 Global Corruption Report, Judge Dolores Español expressed the view that “there are severe hindrances to the smooth delivery of justice in the Philippines: the lack of transparency in the judiciary; the backlog of cases; delays in resolving complaints against members of the judiciary, court officers and lawyers’ and inadequate salaries and facilities.” (Español 2007)

In the following table, the annual official salary of a Philippine Supreme Court judge is

USD32,545. By way of comparison an Indian Supreme Court judge is expected to receive USD7,992; a Turkish USD34,660; a Chilean USD98,616 and a British USD369,601. Accordingly the same report found “Where judges are paid a high salary, they are more likely to resist corrupting pressures.” (Transparency International 2007: 50)

Table 38: The Philippine Judicial System (Transparency International 2007: 258)

Legal system: Civil law, inquisitorial plural (with elements of Islamic law) Judges per 100,000: 2.7 Judge’s salary at start of career: USD5,996 Supreme Court judge’s salary: USD32,545 GNI per capita: USD1,300 Total annual budget: USD24.5B	Percentage of annual budget: 0.6 Are all court decisions open to appeal up to the highest level? Yes Institution in charge of disciplinary and administrative oversight: Not independent Are all ruling publicised? Yes Code of conduct for judges? Yes
Sources: jbc.supremecourt.gov.ph, Supreme Court Finance Department 92005), World Bank Development Indicators 2005 and General Appropriations Act 2005	

The meagre salaries is a symptom of ‘chronic underfunding’ for the sector contributing to the “long delays in resolving cases. On average, it takes five to six years to resolve an ordinary case in a trial court. If it goes to appeal, a further six years could elapse before a final verdict is received.”(2007: 260)

Español also notes the political interference of the judiciary “which sets a tone for the behaviour of the lower courts” and incidents of “executive encroachment on the judiciary for politicians rather than monetary gain.” An example of such encroachment was a 2004 presidential order seeking to limit “fundamental freedom of speech, freedom of assembly and the freedom to seek redress and air dissent against abuses by the government.”

While the Supreme Court declared this order unconstitutional, the Court did require “organisers to secure a permit for rallies in public places.”(2007: 259)

In my interviews, there was overwhelming vehemence and vitriol against the inefficiencies of the judiciary. In one interview I conducted, the placid, rational and reasonable man before me was transformed immediately when the legal system was mentioned. His eyes fired, his cheeks puffed and slowly, plainly stated his opinion of the office bearers and dispensers of the nation’s justice:

“The judicial system here is flawed. Slow. Corrupt. There are higher levels of governance in the regulators than our corrupt judicial system. Under Philippine

law, public officials are responsible and personally liable for official acts. Your personal assets are on the line. In one case, former BSP Governor Fernandez had to adopt draconian measures for all banks. This action was challenged legally and Fernandez's own estate was attached to the court action. The system's corrupt, the stakes are high." –private sector 1

This echoes the experience of former BSP governor Jaime Laya's view of the judiciary in Paul Hutchcroft's book:

"Former Governor Jaime Laya noted that even martial law "didn't seem to stop the lawsuits against Central Bank personnel". He actually laughed as he told me how the Central Bank legal office has 'never won a case.' But the former head of the bank supervision sector [Carlota P. Valenzuela], who has herself been sued doesn't find it a laughing matter: "Why only in this country do the regulators go to jail, and the bankers go scot-free?" (Hutchcroft 1998: 8-9)

The slow rendering of justice is also an important issue:

"The judicial system here has been criticised because of the delay in rendering decisions. Judgement delayed is judgement denied. There are certain rules to follow after a decision has been made but it is not strictly implemented. The choice of judges are strongly influenced by politics [which in turn influences] the rendering of justice. The perception amongst the masses is only the rich can get justice in system. That perception has not changed." –private sector 2

This is supported by an ADB report which noted delays in justice administration were "a major, persistent challenge" (2009: 58) and other interviewees who themselves were involved in legal action and had firsthand account of the length of time it took for judicial decisions to be handed.

"In 1994, we were hit by severe labour problems. [The plant we bought] had a militant union and [the previous owner] had closed off the plant. After 13 years, the Supreme Court found judgement in our favour." – private sector 3

"In 2001, I was one of the complainants ... [In 2007] we're still under a Supreme Court restraining order." –public sector 1

The length of judicial cases merely illustrates the institutional weaknesses in the country.

In 2007, the Ombudsman requested the Philippine Bar Association to investigate reports that its members were involved in corruption. (Acosta 2007) Overwhelming public displeasure at the judiciary is palpable. Then Supreme Court Chief Justice Reynato Puno linked this discontent with the democratic fabric of the country and the concept of liberty:

“So long as the vote of even a single citizen is made a mockery of, we are not free. So long as the Filipino is hounded by lack of education, we are not free. A person is not free who does not understand his rights and responsibilities to society. So long as people are destitute and leave our country because of hopelessness in the future, we are not truly free.”-Puno in Coloma (2007)

Continued reforms in the judicial sector, like other branches of government, will likely remain influenced and motivated by political will and commitment. (ADB 2009: 61)

9.4.2.1 The rule of law – or lack thereof

“The rule of law is the alternative model to the rule of terror, the rule of money and the rule of brute power. That is our justification as a profession.”

-Former Australian High Court Justice Michael Kirby in Marr (2009)

An ineffective and inefficient judiciary undermines the rule of law. Enforcement of the law is a pre-condition for political and socioeconomic stability as it not only legitimises the rule of government but provides recourse for discontented citizens. (Rose-Ackerman 2008: 329).

A strong judicial system encourages social order. An environment without the certainty of the law is a recipe for chaos, distrust, pessimism and bitterness. As a former American colony, the liberal ideas of democracy are well-known and widespread but they are not present institutionally and in practice. This is reflected in many of my interviewees who felt a sense of anger, frustration, disillusionment and cynicism in the (lack of) enforcement of the law:

“Rules are violated brazenly here by people in power. Show [us how] you can establish the rule in an environment of lawlessness. You can’t invoke the law in an environment of lawlessness. The law is brazenly and routinely violated by the government. There is no respect. If you complain, they charge you in courts. The process takes forever and the culprits then disappear to the USA or an unknown

place. If people are good, laws are useless. If people are bad [the laws are as equally] useless.”- private sector 1

“The Philippines has a weak state and the elites feel [they are] above the law. The rule of law is not happening here.” – private sector 2

The attitude seems to be that the law is a suggestion and an advice. Echoing the notion that corruption has two faces – the corruptor and the corruptee - the cause of the private sector is not helped when other private sector players actively break and influence the law:

“There are a few players and it’s an uneven playing field. There is a huge competitive advantage for big corporations. They control the market. But [some of] the big business players don’t play by the rules with their taxes and lack of customs’ payment on goods which decreases their costs but that in turn affect others.” – private sector 3

“Ethics and CSR is aimed at the board and not the management. The hope is the company can be educated in [such things]. If a board says no - [sometimes] the problem is the board itself. It’s the one that dictates corruption.” – private sector

4

The above comments support Rose-Ackerman’s observation that the short-term nature of corruption detrimentally affects private-public sector interaction leading to a race to the bottom (2008: 328). The disparity and the unequal playing field were apparent to some of my interviewees:

“On corruption, part of the problem here is the private sector which has been using the state to strengthen themselves.” – academic

Tony Kwok,¹⁰⁸ an anti-corruption consultant in the region and former Deputy Commissioner of Hong Kong’s Independent Commission Against Corruption (ICAC), was hired by President Macapagal-Arroyo as her anti-graft adviser. Kwok’s prospects for the Philippines to seriously attack the cancer of corruption are not optimistic:

“Here, lawmakers failed tremendously because the corruption law is terrible and

¹⁰⁸ Biography – Tony Kwok http://www.kwok-manwai.com/html/profile_e.html accessed 2 March 2009

inadequate.... Graft is still viewed as one of the country's top problems. Shady practices hold back FDI and there is widespread tax evasion [thwarting] state efforts to significantly boost tax revenues."-Kwok in Reuters (2007b)

Kwok suggests that Manila "upgrade its anti-corruption laws and speed up the judicial process to really tackle the problem" but it is convincing the public that government is serious about tackling corruption which will be the main obstacle: "if people are cynical, there is no chance."

9.4.3 Elections

After the disastrous and scandal-ridden administration of President Joseph Estrada¹⁰⁹, his Vice President Gloria Macapagal-Arroyo took over the highest office in the land in 2001 after another bloodless People's Revolution that saw his ousting¹¹⁰. The 2004 elections was one way to re-enforce Macapagal-Arroyo's presidential legitimacy and to gauge popular support for her administration. The President won the election by a million votes.

In 2005, there publicly emerged several wiretapped recordings¹¹¹ of President Gloria Macapagal Arroyo (GMA), her husband Mike Arroyo and other supporters and members of her administration ringing up then COMELEC Commissioner Virgilio Garcillano during and after the 2004 Presidential elections (Coronel 2005, PCIJ 2009).

The conversations between the President-elect and the Electoral Commissioner, at best light, showed undue influence exercised by the executive on the bureaucracy. At its worst, it showed the illusion of Philippine democracy (David 2005, 2007). Now

¹⁰⁹ President Estrada and his manipulation of the Philippine Stock Exchange through the company BW Resources, is widely credited as the straw that broke the camel's back which saw his eventual expulsion from the presidency: "The scandal would indubitably be etched in the annals of the Philippines securities market as the most brazen manipulative scheme with over 200 individuals (mostly friends of then President Estrada) involved." (Santos 2007: 82)

¹¹⁰ EDSA stands for Epifanio de los Santos Avenue which is a main orbital road around Metro Manila. The gathering for demonstrations is underneath a confluence of main roads. The ousting of Estrada was known as EDSA 2. EDSA 1 saw the ousting of dictator Ferdinand Marcos after he lost the 1986 elections to Corazon Aquino, widow of the assassinated (under Marcos orders) Benigno Aquino. EDSA 2 recalled the same bloodless overthrow of a president who had lost all credibility. See Philippine Daily Inquirer archives

<http://www.inquirer.net/specialreports/theestrada-watch/archive.php> accessed 19 March 2009

¹¹¹ This of course begs the question how such recordings were taped in the first place and who leaked them. See David (2007)

infamously known as the “Hello Garci” scandal¹¹², the malleable foundations of the country’s democratic institutions were rocked by allegations of electoral fraud at the highest level. Credibility and legitimacy are fine things and this incident reinforced the fallibility of the government machinery in the face of a few powerful, political elites as the incident showed “the level of politicisation [in COMELEC] under the Arroyo government is perceived to be particularly grave.”(Hutchcroft 2008: 152, 154)

In 2005, a Senate inquiry was told her husband “had flown twice to Mindanao in a private helicopter a couple of days before the 2004 presidential election to deliver boxes containing about P500M. It was in Mindanao where massive electoral fraud was allegedly committed to ensure the victory of Ms. Arroyo.”(Bonabente 2009) For the embattled Garcillano, his surreptitious departure from the country to avoid appearing before a joint committee after a summons became an international incident. Indeed the Singapore Government issued a *note verbale* that Garcilano did pass through Singapore for London resting rumours that he was still in the country as various machineries of government issued conflicting information over his whereabouts and his passport(s). (Philippine House of Representatives Report 2007).

The fallout from this scandal has tainted this administration since these recordings were uncovered. There is a feeling of helplessness and despair in the executive amongst interviewees:

“The government is growing weaker. First of all, it has a lot to do with the credibility of government. That’s why elections are important as it gives the mandate to leaders. What happened in 2004 the institutions were not strong to begin with, and they have become weaker.” – private sector 1

The incident also showed widespread lack of trust and loss of legitimacy:

“There is the unpredictability of corruption. The ‘Hello Garci’ scandal. Why did the president get caught? They [government] were monitoring the commissioner whom they were counting on to work for them. [But they] couldn’t trust the commissioner due to the [unpredictability of corruption]. The president ended up calling the commissioner and gets caught up in the tape.” – academic

¹¹² See the Philippine Daily Inquirer’s extensive coverage of the affair <http://www.inquirer.net/specialreports/hellogarci/view.php?db=o&article=20051120-57109> accessed 19 March 2009

“Here, there was the case of Garci whose departure was denied. But Garciliano passed through Singapore. The Singaporean government testified to that. He was issued a [new] passport without the Singaporean mark. But it was a new one without any marks at all. What happened to the old one? COMELEC/Garci was asked by the President to cheat for her. The Hello Garci was to avoid scrutiny. He disappeared, was caught and was documented to have passed through Singapore on his way somewhere in the Middle East. The Singaporeans attest to that. Several months later he said he never left the country. He had a new passport. Clean one. It was a bogus passport.” – private sector 2

“Now it’s centralised corruption – more so at lower levels as well. Now it’s so blatant, that if they [offenders] get slapped down [they say] I’ll give you back the money so you can let me go. There is no more morality. If the leader can say “I cheated”, it’s leadership by example.” – private sector 3

Reforming COMELEC was called for by interviewees. Elections are the ultimate representation of popular democracy. If there is no trust in the government agency that oversees the electoral process, then democracy itself is under threat:

“The most fundamental of all reforms is electoral reforms. If there’s no electoral reform, if there’s rampant cheating, there’s no accountability. It fosters division and divisiveness rather than unity.” – private sector 1

Most my interviews conducted with the private sector did not occur until after the mid-term elections of 2007. This was a pragmatic way of uncertainty avoidance on my interviewees’ part - to avoid violence that may erupt after the elections and to be indisposed to public officials seeking funds to furnish their election campaigns.

The 2007 elections were a test of support for the current presidential administration. Again, Mindanao was a sore point with electoral fraud revealed in the province of Maguindanao. One academic interviewee was an electoral observer in the region:

“There were major problems in the counting of votes as they were mostly false votes by the ruling family [in the region]. But it’s important to preserve that democratic space. During Maguindanao we were able to show what was going on with the elections [uncovering the fraud]. In that sense, there is that freer media and in that sense [we were] successful to show there was [electoral] corruption in

that province.” – academic

The other notable result from these elections were the elections of notable opponents of the administration including that of a priest, Eddie Panlilio, who (voluntarily de-robed so he could participate) became governor in the President’s home province of Pampanga, defeating political dynastical clan incumbents and supporters of the president:

“The [victory of the] priest in Pampanga shows that people want more upright people...people aren’t blind. Those perceived to be bad, lost. It’s a good sign. The people are harking to make the distinction between good and bad. So there’s hope. The momentum will continue. ” – private sector 2

Panlilio revealed in October 2007 that he and fellow governors received a handout of P500,000 from Malacañang Palace. Compounding this amateurish and blatant way of disbursement, the bundles of money came in brown paper bags as the photo below shows (Orejas 2007).

Exhibit 11: Photo of Pampanga Governor Eddie Panlilio

 A photograph of Governor Eddie Panlilio, a man with dark hair wearing a white short-sleeved shirt, holding up a thick stack of Philippine 100,000 peso banknotes with both hands. He is standing behind a table with several microphones in front of him. The background is slightly blurred but shows a red banner with some text.	<p>Left: Governor of the province of Pampanga, former priest Eddie Panlilio shows the bundle of money he received from Malacañang Palace at a press conference.</p> <p>Source: Philippine Daily Inquirer http://newsinfo.inquirer.net/inquirerheadlines/nation/view/20071016-94677/Panlilio to Palace%3A Tell truth on money</p>
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The other notable addition to the Philippine political scene was the former military officer Antonio Trillanes who was elected as senator whilst still in detention over his role in a 2003 coup against the President. His selection despite his detention was seen as a symbolic popular defiance of a graft-ridden administration. (Farolan 2007, Ramirez 2007)

In November 2007, Trillanes was again part of a short-lived coup against the President. Supporters of Trillanes sieged the Peninsula Hotel in Makati for a several hours but like

the previous bloodless coup he was involved in, ended in surrender. (Philippine Daily Inquirer 2007b) At the time of writing Senator Trillanes remains detained and unable to discharge the duties of the position to which he was elected. (Alave 2008) Indeed many things need to be addressed to salve the integrity of elections and their outcomes in the country:

“Only here in the Philippines can we celebrate that only 100 people were killed during these elections. So much economic power depends on political power. Reform has to be broader – change the whole structure, electoral reform. There must be a higher sense of nation rather than specific interests.” – private sector 3

“We claim to be a democracy, but how practical is that? In these elections?” – private sector interviewee 4

Newspaper editorials on the election captured the pessimism and cynicism of the 2007 results, while the unusual nature of Philippine politics meant that the former Electoral Commissioner Garcillano who was cleared of perjury in 2006 nevertheless boldly ran for office in the 2007 elections but was defeated (Gomez 2007). Or as Rose-Ackerman bluntly puts it:

“Corrupt governments lack political legitimacy. This loss of legitimacy can lead to violence in the form of anti-government riots by people who are frustrated by the venality of public officials.” (2008:332)

Speaking to those who have interacted with the President, one spoke about her obstinacy when deluged by a barrage of attacks¹¹³. For another, one recalled her ostracism at a function of pro-American supporters after she pulled out Philippine troops from Iraq in 2004. Anecdotal evidence also suggests a high transaction cost if one wishes to conduct a face-to-face meeting.

A legacy of her presidency is the sad indictment and nature of political clans. Macapagal-Arroyo’s father was a former President of the Philippines and a fierce opponent of Ferdinand Marcos. For the administration to be seen to be engaging in the same corrupt behaviour that her father’s enemy was actively preoccupied with, it is with some regret the circle had made a full revolution.

¹¹³ On the issue of the NAIA Terminal, she was described as “not taking [my] advice. She’s a pig-headed woman.” –private sector interviewee

9.4.4 Bidding for Government Contracts

For my private sector interviewees, the bidding and tendering process for government contracts is rife with opportunistic behaviour from public officials. For example, in the tender for toll roads, there is a formal process to handle unsolicited bids which seems to be uniquely Filipino:

“When you have unsolicited bids for toll roads that go to tender, you have the processing of unsolicited bids. This is the only country I know where there is a whole different process for unsolicited bids. So when you commission a feasibility study you need to ask what are the other issues that have to be addressed” – private sector 1

And so are ‘Swiss challenges’ where third parties are allowed to make better and unsolicited offers (or challenges) for a tender during a designated period (Hodges 2003: 2-3). The Swiss challenge currently creates a great deal of uncertainty amongst original bidders. In the following passage, a public sector interviewee relates how their organisation wishes to redevelop the land and building it is currently occupying but a Swiss challenge has delayed the process and created unpredictability:

“We are still waiting the clearance from NEDA [National Economic Development Authority] which will be a built, operate and transfer procedure. The initial proposal is from the developer and it has to undergo a bidding process but it is part of the bidding rules. We have renegotiated contracts that are unsolicited bids. In announcing it, we are seeking other proposals of the initial bid (a Swiss challenge), so there could be a public bid.”-private sector 2

For a country known for an opaque bidding system, rules that are changed midstream deter investor confidence rather than instilling it. A corrupt process manifested in the bidding process either corrupts participants or drives away genuine bidders with ‘honourable’ intentions. (Tort 2007)

In the case of one infrastructure project dealing with Manila ports, one bidder was disqualified in the screening process because it refused to have a waiver that would give the government immunity from legal suits if there was an irregularity in the bidding (Tort 2007); while another newspaper article pointed at the interference of a politically

well-connected company (Pascual 2007) which undermined the integrity of the bidding process. This was backed by off-the-record evidence during my data collection.

9.4.4.1 Ninoy Aquino International Airport (NAIA) Terminal 3

Questions over the integrity of executing a government contract in the Philippines have its exemplar in the well-documented debacle that was Manila's Ninoy Aquino International Airport (NAIA) Terminal 3 (Kinloch 2004, Gavieta 2006). Construction began in 1997 won by a consortium that included Germany's Frankfurt airport construction arm called PIATCO-Fraport AG. The terminal was completed by the foreign investor consortium in 2002. However, it was only in 2008 that it finally opened up. The intervening years between its completion and opening was spent arguing over the validity of the contract as the Arroyo government voided it due to the corruption of the previous administration. The Supreme Court ruled the contract invalid but required the Arroyo government to pay compensation before granting the government control over the terminal. (Kinloch 2004: 16, PDI 2008). At the height of the dispute between the government and the private sector contractors, the government expropriated the airport (Yasay Jr. 2008).

Expropriation is a highly hostile act and a strong deterrent to investment. Upon receiving a German government investment guarantee "as protection against political risks for its equity investment made in the Manila project", the executive board chairman of Fraport AG, Dr. Wilhelm Bender, expressed his bitterness over what happened:

"The unlawful behaviour of the Philippine government will not pay off. We will not accept the expropriation done and we will get our money back for our engagement in the Philippines." (Fraport 2008)

While in situ in Manila, it was strange to see a newly built terminal that remained closed due to ongoing legal battles while arriving passengers (including this one) were herded into the several decades old airport giving an underwhelming first impression of the country. The Terminal 3 incident exemplifies high levels of political risk present in the country. (Kinloch 2004: 15)

Doing business is rather hazardous in the country when formal processes are not followed and the opaque manner in which transactions are completed is a main source of frustration. When contracts are not honoured, disregarded or cancelled, investor

confidence is undermined. For one Japanese foreign investor, Takenaka Corporation, its contract with the government to complete and repair the Terminal was terminated.¹¹⁴ The role of the judiciary in the case was critical as the courts gave the impression of being highly politicised and unable to make an impartial judgement solely based on the merits of the case. (Chen 2004: 12-13)

For my interviewees, Terminal 3 was symbolic of the difficult business environment in the country and the ever present vested interests that interfere with any prompt resolution:

“The Philippines has a very bad reputation: the management of the economy, political instability, politicking over the airport terminal...it has resulted in a very bad reputation of corruption and uncompetitiveness.” – private sector 1

“Foreign and local chambers [of commerce] give a high priority for Terminal 3. It’s the symbol of the inability to do anything [in the country]; it’s a critical thing for the first impressions of the Philippines. It is a very poor impression. [The President] knows everyone’s pushing her on it...There’s the matter of who’s going to run it. Lucio Tan wants 18 to 24 gates. Tan’s PAL has Terminal 2. Terminal 2 is intended for the domestic terminal but Tan controls it.” – private sector 2

Another interesting outcome from the NAIA Terminal 3 issue was what can be inferred the price of unpredictable corruption in the execution of a government contract. In one newspaper article, it was reported the company sought to recover \$425M even though documents showed a construction cost of \$121M. (Gagni 2007b) The discrepancy between the construction cost and the claim amounts to \$304M or 71.5% of the total claim. Was this the financial price of corruption?

As an infrastructure project, ownership laws come into play and the local owner must have funds funnelled through them. Also the ongoing legal costs are another source of

¹¹⁴ For the Filipino government arm dealing with the contractor, the reason behind the termination was straightforward: “We had been negotiating with them to complete the construction of the terminal and issue a guarantee for a very long time now. We waited for two years *pero paikot-ikot lang kami* (we kept going in circles.)” For Takenaka, the response was: “I am sorry, this is a very crucial time. Please ask your government.” From the Japanese Export Trade Organisation (JETRO) representative in the country: “It’s complicated, it’s so difficult to give an opinion. We only read it in the papers, but similar to the overall sentiment, we would like to see the immediate opening of the new terminal.” In Estavillo (2007b)

contention. As in any legal dispute, overstating costs are also par for the course as a court nominally reduces any amount.

Nevertheless, the worrying trend of the way business is done in the Philippines is echoed in the next section over another government contract, this time over a proposed national broadband network.

9.4.4.2 National Broadband Network (NBN)

Apart from the NAIA Terminal, another notable government contract came under scrutiny over questions of the bidding process.

This case was of a proposed broadband network for the country. (Bonabente 2009) Given the country's poor record in telecommunications infrastructure, this was a way for a technological leap forward for the country.

However, in 2007, questions were raised over the contract process and the opaque way the award given to a Chinese company. The position taken by the government that it was a Memorandum of Agreement (MoA) signed by the President upon her visit to China to drum up foreign investment for the country. A contract related to the MoA also went missing (Del Mundo 2007). Indeed two academics questioned the intent and wisdom of the proposed network given there were more pressing infrastructure needs in the country:

“University of the Philippines School of Economics Raul Fabella and Emmanuel de Dios reported that getting a foreign loan to fund a third IT backbone should be the last of this resource-strapped government's priorities... In the IT sector, private business has proven to be quite aggressive in making costly investments for infrastructure, and could be relied on to keep doing so...Professors Fabella and de Dios had an eloquent way of zeroing in on the problem: what we lack is not in fibre optic; it's in *fibre politique* - or moral fibre, if you wish.”-Business Mirror (2007e)

This sentiment was echoed by one interviewee:

“There is a lack of moral fibre. This is not an honest country.” –private sector 1

The lack of transparency and the heavily politicised nature of both the Terminal and

NBN issue became emblematic of the problems of the Arroyo administration.¹¹⁵ The manner in which the way government contracts are tendered – or not tendered – questions the nature, sincerity and delivery of future infrastructure projects in the country.

The next sections look at other issues on corruption that came up during my fieldwork: its impact on gender, its effect on investment and quality of investors, poverty and the OFWs.

9.5 Gender Representation and Corruption

One male interviewee raised the issue of gender in terms of mitigating the risks of corruption:

“[In terms of] the value system here, I’d hire a woman over a man. They work harder, are less corrupt. The women [in my organisation] would work 10% more than the men and they also do the household work. The women would do the budget and they’d also be the breadwinners but ensure the man’s ego.

“These are cultural aspects – the boys get pampered, the women are the workers. Given the choice in this office environment, I’d discriminate in favour of women. Most of [the men] are macho guys with a girlfriend on the side. It’s a generalisation that applies but women work hard here. Culturally, Filipinas were brought up to take decisions, and there are powerful women up the corporate ladder. They are very accomplished so there’s not much discrimination in place. The women were brought up here to take responsibility in the family environment.”-private sector 1

The perception of the integrity of a gender has had past examples including the following observation from a 1942 Time magazine:

“The Filipino is a stubborn gambler even for the Orient, an unbusinesslike dweller in the Far East of shrewd traders. His wife handles the money of the household because otherwise he gives it away, loses it, bets it, or spends it.” – Time (1942)

¹¹⁵See the Philippine Center for Investigative Journalism blog on the issue <http://www.pcij.org/blog/?p=1977> accessed 23 March 2009. See also Cendaña (2007).

There is some support for this notion that females are the less-corrupt gender in the literature. Anand Swamy and colleagues found that females were “less likely to condone corruption”, “less involved in bribery” and “provides some support for the idea that, at least in the short or medium term, increased presence of women in public life will reduce levels of corruption.” (Swamy et al 2001: 26)

However caution must be taken as the authors suggest “it is conceivable that our results reflect gender differentials in *acknowledgment* of corruption, rather than in *incidence* of corruption.” (Swamy et al 2001: 27). Similarly, Rose-Ackerman suggests that “Governments with more female participation in politics are less corrupt, and this is consistent with survey evidence suggesting that women are more disapproving of corruption than men.” (2008: 335)

According to a Grant Thornton International survey cited in The Economist, the Philippines lead the world in having the highest percentage of women represented in senior management with around 50%, followed by Brazil, Russia, China and South Africa – well ahead of the global average which is around 22%. With two female presidents since the downfall of Marcos the survey “reflects the tradition of wide participation in society.” (The Economist 2007)

Proportionally, half of the government institutions I accessed were interviews conducted with women while only 20% of my private sector interviews were conducted with women. Further research into this particular area of corruption studies may help determine the extent gender does play a role in mitigating the spread of corruption.

9.6 Corruption Discourages Investment

Corruption is a major obstacle and disincentive to economic growth deterring both internal and foreign investment (Rose Ackerman 2008: 332). Interviewees supported this notion:

“Here we have expensive property. There is no power, no water, and no transportation. We don’t have roads, [so we] fund them independently. The money supposedly spent on roads and bridges here you could have paved the Philippines twice all over had we used it properly.” – private sector 1

Coupled with restrictive foreign ownership controls which mean the local partner has the control but not the financial leverage, the incentive to invest in the country is further discouraged when other countries in the region are more open and business-friendly:

“In Vietnam, we have invested and we’d love to do the same here. But in Vietnam, we are allowed to have an 80% shareholding in the business. It is hard to be competitive when you own less than the majority.” – private sector 2

One interviewee pondered the macroeconomic implications of corruption and its disincentives for the country:

“If you talk about corruption everywhere – whether it was done a little different in the last 10 to 20 years, [the evidence is] a lot of money has left. Perhaps the business environment was better 50 years ago. In the Philippines, all the money has gone overseas. If the money stayed in the country, it could have been used. You can see this in other countries where the money has stayed in the country. It has been used in the country because they have huge infrastructure developments. You can see where it has gone. Here in the Philippines, the money has gone overseas.”-private sector 3

This echoes Hutchcroft’s observation about the lack of loyalty shown to the nation state by some private sector actors: “Unlike their counterparts in South Korea and Taiwan, Philippine entrepreneurs could quite easily take the money and run; there was little sense of *quid pro quo* to a state so utterly incapable of promoting long-run developmental objectives.” (1998: 86)

Thus, corruption discourages both local and foreign investment. In 2009, the umbrella body for institutional investors worldwide and whose members control \$10 trillion of capital (Durkin 2009) and one-fifth of the US equity market (Burgess 2009), the International Corporate Governance Network, published its statement and guidance on anti-corruption. The network’s stance on corruption is reproduced in the following excerpt.

Text Box 12: Why Corruption Matters to Investors (ICGN 2009: 5)

“While making a corrupt payment can enable a company to win profitable business in the near term, it ultimately destroys value, both at a macroeconomic level and at an individual company level. At a macroeconomic level, corruption greatly reduces

efficiency by distorting competition and depriving buyers of economically superior products at the most competitive prices. Examples abound of deficient, unsafe or poorly specified products being delivered at vastly-inflated prices to governments that can ill-afford such waste.

“Corruption destabilises the political process and promotes conflict. It also raises the cost of doing business and deters investment. For investors with exposure across the market, this reduces overall returns by interfering with the allocation of capital to its “highest and best use”. For investors in individual companies that have been disadvantaged by the corrupt actions of competitors, this directly reduces returns, even in some cases threatening commercial survival. For investors in bribe-paying companies, the damage is more insidious, and is felt over the longer term.

“Although corrupt actions can go undetected and unpunished, when they do come to light they can trigger extremely costly and disruptive corrective actions, including legal and forensic investigations, fines, disgorgement of ill-gotten profits, corporate restructuring, dismissal of executive teams, imprisonment, debarment from client procurement lists, employee morale problems, staff defections, recruitment difficulties and reputational damage.

“Companies with a reputation for weak anti-corruption controls, or which are found to have “skeletons in the closet” during pre-merger due diligence, can find that deals are re-priced or even called off. They also will face hurdles when accessing the capital markets of countries where anti-corruption enforcement extends extra-territorially, such as in the US and increasingly other OECD countries, because past actions outside those countries will become within reach of enforcement authorities, thereby raising those companies’ cost of capital.

“Finally, whether or not corruption is detected and punished, a corporate culture that tolerates corrupt payments is also one that is much more likely to tolerate, or fail to prevent, financial fraud, theft of company assets and other actions that will directly harm shareholders. Corruption corrodes corporate culture and undermines the quality of management.”

The ICGN’s position is an acknowledgment of the effect and cost of corruption on investment decisions.

9.7 Corruption Attracts the Best of the Worst

According to the 10th Principle of the UN’s Global Compact: “Businesses should work against corruption in all its forms including extortion and bribery.” (UN and Transparency International 2009) With Transparency International, the UN’s Global Compact has issued a reporting guidance on anti-corruption measures. This is an encouraging sign that there is now a great deal of openness to discuss the detrimental effects of corruption and the obligations from both sides of the transaction.

In the Philippines, it is hard to do business in the country without engaging in some form of corruption and corrupt behaviour. Below are poignant thoughts on corruption and its effect on the Philippine business environment from some of my interviewees:

“The Philippines has one of the most difficult business environments in the world. Aside from the façade of speaking English and being friendly, it is difficult to do business here. In order to be successful here, it is very difficult. Unless you’re corrupt.” – private sector 1

“The problem is legitimate companies are forced to behave unethically because of corruption. Corruption has two faces: the corruptor and corruptee. Corruption is a product of poor, public governance.” – private sector interviewee 2

“In this business environment, the businesses who comply with the law are at a disadvantage. Ethical standards will not survive in the local business environment. Here, if you will not cheat, you will lose the business. If you don’t abide, you go by the tide. If people are good, laws are useless. If people are bad, it’s useless.” – private sector lobby group

What attracts a foreign investor to do business in a nation-state known to be corrupt, difficult and unpredictable? Are they themselves corrupt, immoral, unethical or do the financial opportunities outweigh the less desirable elements of a business transaction? Does a corrupt environment corrupt the potential investor or is the investor already well-versed in doing business in an opaque way? Does the investor take the liberty of lowering their internal ethical standards in a corrupt business environment? The quality of foreign investors attracted to the Philippines was a point that I came across intermittently with people I spoke to and interviewed. Asking a well-informed source about press coverage of a multi-billion dollar (USD) investment in the country on whether the foreign investor would have had to make some unofficial payments, the response - with a withered look that implied this question was redundant and I was being naive - “Of course they would have.”

One academic was more articulate and blunter about the quality of foreign investors who are present in the country:

“Many MNCs will come in to this country and become bad people. Many of these corporations...they [may be] good in [say] Germany but become bad players here.

Is it a coincidence? A product of the environment? Poor corporate governance is not a monopoly, monopolised by Filipinos. It is everywhere. When you enter the country, it's the rule of the same. The foreigners can be as bad as the Filipinos can be good outside the country.”-academic

An example of how undesirable a foreign investor can be is related in Text Box 13 which looks at the heavy promotion of breastmilk powder substitutes in a country where access to clean water is a major challenge. Fundamentally, the issue of promoting breastmilk powder is down to ethical investment. However, in a country where government regulations are selectively enforced, the onus of responsibility on investors to exploit this weakness is undeniable:

Text Box 13: The Breastmilk-Substitute/Powdered Milk Industry in the Philippines

“Gina’s newborn girl has just contracted pneumonia. A few years ago, she lost twins to premature birth. Her baby looks malnourished and small for her age. Despite her family’s poverty, Gina stopped breastfeeding and opted to feed her baby with infant formula after getting convinced by TV ads. Hours of TV exposure led her to believe her baby would grow healthy and intelligent if she is fed with breastmilk substitute. By failing to breastfeed, which is also a natural way to limit pregnancy, Gina is again on the way.” (Jimenez 2007)

During my field research, one of the more notable socioeconomic issues the country was facing was the promotion of powdered milk to newborns and infants. Watching the television, listening to the radio or reading the newspaper, I would come across the heavy promotion of these products. Every ad break featured some happy mother with an equally happy child whose cheeks were bursting with happiness because s/he had grown up in a household where powdered milk was consumed with the word “Gold” at the end of the product’s name - or “Platinum” to indicate the product was P250 dearer.

While there is a certain amount of parochialism and xenophobia that I felt were present in some of my interviewees, there was little concern about the promotion by these milk companies who were usually subsidiaries of MNCs. Wasn’t Nestlé’s powdered milk promotion in 1970s Latin America a Harvard Business School case? (Austin 1990) How could this situation still exist in any country in the world today?

Only 7% of Manila’s population is connected to a sewer system, far lower than Kathmandu (20%) and Dhaka (30%). Sanitation and sewerage infrastructure are heavy financial burdens for the government (PDI 2007c). An estimated 16,000 Filipino children under 5 die because of their mothers’ failure to breastfeed and improper feeding; P4B is the amount spent every year by the powdered milk industry to promote bottle feeding; P21.5B is spent annually to buy infant formula or 13% of a monthly income of an average Filipino family which goes to buying the product (Jimenez & San Juan 2007).

In 2004, the Department of Health (DoH) started to strengthen the implementation of the Milk Code (1986) which sought to counter the decline of breastfeeding rates in the

country. The Department introduced the Revised Implementing Rules and Regulations (RIRR) which specifically targeted the advertising and promotion of breastmilk substitutes, labelling of the substitutes, incorporating health warnings such as banning the nutritional claims of the products. The breastmilk substitute industry in the country was galvanised and opposition to the RIRR reached the transnational-political levels. According to the industry's lawyer, at stake was USD208M in revenues the industry stood to lose if the RIRR went ahead. (AP 2007)

In a country where access to clean water for the majority of the population is a daily challenge, it was unsurprising UNICEF research found "poor and near-poor families who use formula incur 39% more medical care expenditures and 99% more in medical charges than non-formula users." (Monsod 2007) The initial ban was overturned on appeal. A vocal critic of powdered milk promotion was the UNICEF Philippine country representative, Nicholas Alipui, who received a complaint from the International Formula Council (IFC) which represents global milk companies such as Nestle, Abbot Laboratories, Wyeth and Mead Johnson. The lobbying efforts of the IFC overwhelmed Alipui:

"I was surprised. I didn't know that we would instantly become the subject of international scrutiny of the sort. I think that was when I first realised the enormity of the challenge that we're facing and how big the opposition from milk companies was going to be. The nerve of milk companies comes from the fact they do have lobbyists around the world who have an exaggerated impression about themselves and what they can actually achieve in terms of influence within various organisations and child-rights groups....the fact that they are able to penetrate [Philippine government] organisations to the point of trying to undermine [UNICEF] representatives is an indication that they have enough influence within these organisations to challenge individuals who represent them in their respective countries."(Alipui in Jiminez 2007)

Similarly, the CEO and President of the powerful business lobby group (which represents 3 million businesses¹¹⁶) Washington DC-based United States Chamber of Commerce, Thomas Donohue, exercised his organisation's wide influential leverage on the country writing to the President of the Republic on the 11th of August 2006 requesting a reconsideration of the RIRR's implementation:

"Dear Madam President, I recall with fondness our encounters over the last years and the US Chamber has been watching with great interest the recent developments in your country [however] it has been brought to my attention that a recent regulatory decision by an agency of your government would have unintended negative consequences for investors' confidence in the predictability of business law in the Philippines. In particular we are concerned about the effects this decision will have on the pharmaceutical industry.

...

"First the [RIRR] prohibits all marketing of infant formula to children up to three years of age...[secondly the RIRR] also treats infant formula as a potential hazard by requiring warning labels without any scientific justification, a step which would needlessly alarm potential consumers and is not required either by Philippine law or international norms.

...

¹¹⁶ US Chamber of Commerce (2009) About Us <http://www.uschamber.com/about/default.htm> accessed 5 March 2009

"If regulations are susceptible to amendment without due process, a country's reputation as a stable and viable destination for investment is at risk. We know you would want to avoid such a situation occurring. The US Chamber of Commerce values highly the mutually beneficial trade relationship between our two countries... We would therefore be very grateful if you could re-examine this regulatory decision in light of these concerns."(Donohue in PCIJ 2009)

With political pressure exerted from the highest level in the land, the Supreme Court handed down its decision on October 2007 and did not deliver an unequivocal victory on either side of the milk product substitute debate (Rempillo 2007). There was not a total ban on the marketing of breast milk substitutes but the Court reiterated the Department of Health's "power to regulate, screen and decide on the advertising and promotion materials of these products." (Soe 2007)

The Supreme Court decision was widely anticipated in the region. The breastfeeding rate in the country was 16% in 2003 but the rate was worse in Thailand (5.4%) and Vietnam (15%).(AP 2007) In comparison, 84% of Australian babies are breastfed on hospital discharge, 61% at three months and 49% at 6 months.(Australian Breastfeeding Association 2000) An Australian expatriate related that when she gave birth to her son in a Manila hospital in the 1980s, she had to be vocal against the nurses' promotion of milk powder and insist upon breastfeeding her child.

Writing for the British medical journal, The Lancet, Rene Raya ruefully stated:

"Scientists and policy makers have declared, urged and exhorted countries to exert every effort to increase breastfeeding rates. 25 years of scientific evidence have accrued since the signing of the International Code of Marketing of Breastmilk Substitutes in 1981...the UN's Food and Agricultural Organisation (FAO) has warned that powdered infant-formula is not a sterile product.

"Aggressive marketing practices for breastmilk substitutes have been blamed for the decline of breastfeeding in the Philippines where only 16.1% of Filipino infants aged 4-5 months are exclusively breastfed...there have been suspicions that violations of the Milk Code have occurred in the past with over-zealous sales techniques. Mothers receive various gifts and are targeted to attend classes where infant formula milk is promoted [and] much remains to be done and the struggle goes on to restore the culture of breastfeeding in the Philippines." (Raya 2008)

Akin to the climate change debate, there is overwhelming scientific evidence supporting the superiority of human milk against breastmilk powder substitutes for infants. Yet the lucrative profits companies make from this product is a sad indictment of exploitation by first world companies in weak third world states.



Cartoon: Courtesy of the Philippine Daily Inquirer, Saturday, 16 June 2007 Vol. 22 No. 188 p.A12

MNCs may behave in impeccably in their home countries. However, their operations in developing countries which have malleable laws and known corruptibility of public officials may render a more flexible behaviour.

Subsidiaries of American listed companies operating in the Philippines have two relevant legislations they need to consider when the delicate matter of corruption rears its head: the Foreign Corrupt Practices Act (FCPA)¹¹⁷ and Section 404 on Internal Control of the Sarbanes Oxley Act (SOX)¹¹⁸ Both laws focus on the financial reporting of a company's operations:

“Major foreign corporations such as the American ones follow SOX. Some are quite strict and rigid about it. On the other hand, there are other listed [corporations] who follow SOX but have a practical approach to what is being done here. Even major corporations have to bend the rules a bit. The big issue is

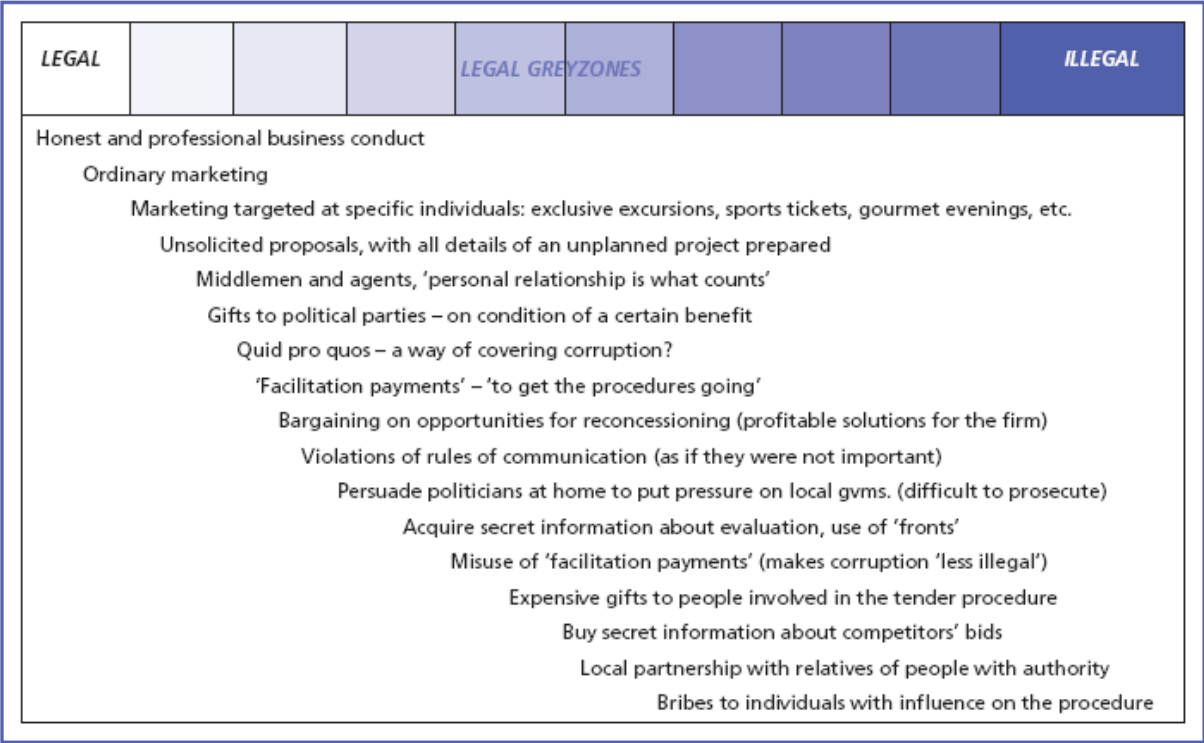
¹¹⁷ US Department of Justice (2009) US Foreign Corrupt Practices Act <http://www.usdoj.gov/criminal/fraud/fcpa/> accessed 3 March 2009

¹¹⁸ Institute of Internal Auditors (2008) Sarbanes-Oxley Act Section 404: A Guide for Management by Internal Controls Practitioners 2nd Edition, 10 March <http://www.theiia.org/download.cfm?file=31866> accessed 2 March 2009

to maintain proper accounts. There is a blind-eye to the activity that goes on whether it's a *gift fee*, *marketing fee*, *canvassing fee*, *contractor fee*, *consulting fee*, *referral fee* where proper commissions are paid. There are all sorts of arrangements.” – private sector 3

The following figure from Transparency International’s 2007 Global Corruption Report highlights the grey areas in between legal and outright illegal behaviour of a business transaction:

Figure 44: Influence on Tender Procedures (Transparency International 2007: 340)



For the majority of Australian companies present in the country, most are active in the infrastructure or mining sectors. For one Australian mining company, Lafayette Mining Limited (ticker symbol: LAF.AX), their foray to operate a mine on Rapu Rapu Island in Albay Province was both a natural and public relations disaster.(Oxfam 2009) For one business commentator, Lafayette’s action immediately after an incident was a warning on how not to do business in the country:

“They had a [cyanide] spill. It was done very badly. The whole thing could have been handled but they ignored the people who were complaining. They didn’t counteract the attacks. They were silent throughout the whole episode and

thought [keeping quiet] was a better strategy. But here, it is the opposite. You need relationships especially in government to correct the situation very quickly.”-private sector 4

For development agencies in the country, the challenge is how to distribute aid in a way that does not promote corrupt practices. How do they bypass corruption? One observer points out this conscious approach:

“Ausaid is building up expertise and skills to create change rather than [give] aid itself. They are developing capabilities [which counters] the likelihood of situation for [corrupt] practices.”-private sector 5

A corrupt environment attracts the type of private sector players who are more willing to bend the rules and engage in the informal ways of an uncertain environment.

9.8 Corruption Contributes to Poverty

During my 4 months of living and travelling around the capital of Manila, grinding poverty is never far away. A visitor can see the extensive slums from an airplane window, and on the ground be confronted by all manner of attempts to alleviate one's circumstance; street kids who have no childhood nor schools to go to beg for money and food; housing that is made of three cardboard walls and a plastic sheeting for a roof; adults trying to eke out an income by any means necessary.

Not surprisingly, poverty was an issue that was touched upon by many of my interviewees.

For one interviewee who confronted a lot of corruption in his dealings with public officials, his ability (or inability) to create further employment was an issue he and his peers internally struggled with. In a moment of introspection, he reflected:

“I went through phases here in the Philippines. You want to change something, make a difference to the world, to the poverty here. It goes up and down. You want to change but can't make a change. You start off full of enthusiasm and then reality hits you. What can you do? You become discouraged and you find [ups and downs and then] a neutral phase.” -private sector 1

On the macro-level stance, there was some agreement on how poverty must be tackled

through economic development and how to address current income inequality:

“My point is we really need a new paradigm. [We must have] development-inclusive growth, and managing [the wealth] divide effectively. Yes to opening ownership limits but caution on different levels of development. [We must] take into account poverty levels, [and] align investments with that.” – private sector 2

In 2007, GDP growth was the highest for 30 years. However, optimism was tempered by the reality of poverty and economic growth had not translated to the best part of the population:

“The stock market levels are high, the peso is high, and GNP is high. The Secretary of Economic Planning says there is growth in the corporate and financial sectors growth. But hunger is also higher and so is suffering.” – academic

“Improvements in the economy should be matched with corresponding efforts to attack poverty at the roots and ensure that economic growth translates to a better quality of life for Filipinos living in abject poverty.” – Business Mirror (2007f)

Corruption keeps on punishing those who are already economically impoverished and disenfranchised. Tackle corruption in the country, and poverty will be addressed as well.

9.9 Overseas Filipino Workers

“The poor leave for lack of money, the wealthy leave for lack of hope. But we are not the first, nor are we alone in this tragedy.” (Pangalangan, 2007)

Poverty creates a feeling of hopelessness. A dysfunctional political economy creates feelings of discontent and helplessness. This has meant for many Filipino families, including mine, the alternative is to seek new lives abroad forming the abundant diaspora.¹¹⁹ The term diaspora is based on the Greek word meaning “to scatter and to sow.”(Ember et al 2005: xiii) And so Filipinos have scattered and sowed through all four corners of the earth making new lives and integrating successfully (and for some, not so successfully) in recipient countries. The diaspora lingers on through succeeding

¹¹⁹ For a succinct paper on the effect of international diasporas, see Fullilove (2008)

generations being indicative of the reluctant displacement (Ember et al 2005: xiii) and a schizophrenic relationship to one's place of birth:

“Homeland remains fresh in the minds of migrants. However, many remember it mainly as a corrupt and unjust society made up of mostly poor people with no opportunity for achieving a better life, and a few rich people who exploit them. As James Fallows wrote, “The Philippines is a country full of people who would rather live elsewhere.” (Anderson 2005: 817)

Unlike other countries in the region whose economic development relied upon policies promoting export-oriented industrialisation, the lack of coordinated political vision and will to lift the country out of its continued politico-economic quagmire and dismal financial performance now several decades old (Anderson 2005: 809). This has meant the best of its workers have left for abroad; aggregated - the significance of having 10% of the country's population living and working overseas is staggering:

“People are the Philippines' main export. Last year more than 1M Filipinos left to work abroad as maids, nurses, sailors and in all sorts of other difficult but low-paid jobs. Labour migration is huge, and growing, in South-East Asia, as workers are sucked out of its poorer countries, increasingly to their better-off neighbours, even though these are still themselves sending workers to the rich world. Many of these wandering wage-earners eventually return. In the meantime they send home huge sums—in the Philippines' case, the equivalent of over 10% of GDP. This compensates for the opportunity cost of having, at any one time, 8M of its best workers abroad.” (Economist 2007b)

For many of my interviewees and the press of the time, one segment of the Filipino diaspora, the Overseas Filipino Worker (or OFW), is an important group economically especially because of the value their remittances provide to the country (Schiller 2005: 578-579). Within a generation, the perception of the OFW has changed from that of shame to a source of pride:

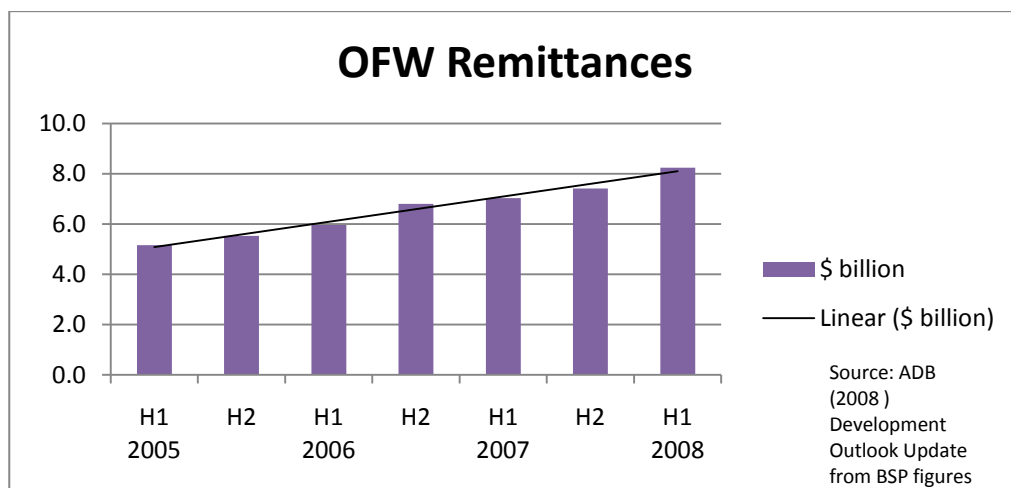
“In the late 70s, early 80s, OFWs were a source of shame. It's a massive change. In those days, they would not talk about remittances as they were ashamed of it. Foreigners avoided talking about it. Now, it's not regarded as a source of shame to know OFWs.” – private sector 1

Today the significance of the OFWs has implications for the country: economically through their remittances, socially because of the brain drain and politically due to the potential power they may exercise in the future.

9.9.1 Economic Impact of Remittances

Economically, the OFW is a formidable segment of the consumer market. Below shows the increased value of remittances being sent to the country from USD5B in 2005 to USD8B by 2008. In a global economic downturn, the remittances provide the means for which the country can keep afloat (ADB 2008: 179-180) as the following figure shows:

Figure 45: Value of OFW Remittances from 2005 to 2008 (ADB 2008: 179)



The OFWs and their families are the new middle class able to exercise financial leverage and capable of leapfrogging the pre-existing class, power and wealth structure of the country. They are used to first-world services and demand or expect such services to be present in the country. They are providing a much needed supply of steady income and investment (Schiller 2005: 576-577). As the OFWs with their remittances to their families provide a steady supply of consumers, this new market means the private sector is also targeting their services around this group who spend most of the year in one land, and a few weeks in the country because of Christmas, Easter or local fiestas:

“OFW remittances are equal to US\$12/US\$13B per year. In this economy, [that amount of money means] real estate and buildings. The first thing they do or what a family wants is shelter. This means a lot for those in the real estate business. It has had a great effect with many different types of [property

development] projects. So after this middle class family have housing, they would buy products to fill the house - a fridge, a car, and so forth. The 20-30% difference in income buys a lot of goods. As long as people don't get jobs or paid here, they will go overseas." – private sector 1

"We are seeing a significant shift. Remittances are increasing [which means] education [is being funded], the investments [are present] to build a small home or start a small business. As long as the opportunities here are not as good as they are overseas, people will leave. Job creation is not keeping up with the population" – private sector 2

Indeed, during my time in Manila, there were a lot of advertisements for real estate developments from apartments to McMansion villages (with the ubiquitous Tuscan-style villa) not so dissimilar from those being promoted in Australia or America. The growth in the real estate sector from 2005-2007 was largely due to OFWs and their increased consumer spending (Cuisia 2007; see Chapter 6).

While doing my fieldwork, the apartment I rented belonged to an OFW who lived in Australia. For Ayala Land a substantial portion of their real estate sales come from OFWs and their marketing strategies mean an extensive website¹²⁰ tapping the overseas market and property roadshows in the USA.¹²¹

Similarly, the business opportunities overseas abound where a substantial OFW community is located. In this case, following the money by following the OFW:

"We've plans to acquire business in the USA. In the USA we're looking at establishing a nurses' development agency – if it's going to be big, if we push through the plans that will be one of our investment opportunities." – private sector 2

The value of remittances mitigated the effects of the global financial crisis in the country. But for the 20M people living on less than USD1.25/day, they still face "significant risk of seeing poverty reduction reversed (AusAid 2009). Thus dependence on OFWs highlights the nation's economic dependence (Nonini 2005: 568). If the remittances should dry up

¹²⁰ Ayala Land (2009) <http://www.ayalaland.com.ph/> accessed 28 March 2009

¹²¹ Ayala Land (2009) Events, Promotions and Updates: Ayala Land Representatives will be in LA, SD, SF, Chicago and NC <http://www.ayalalandpremier.com/events.php?id=1879> accessed 28 March 2009

whether through unfavourable labour laws or economic downturns in host countries, the Philippines will be vulnerable:

“... the credit crisis hasn't really hit the Philippines as hard as may have been initially thought. The banks are doing business as usual with no drastic change to their policies. Maybe there's something to be said about being "under the radar" of sorts. But the thing that worries people here is the fact that we rely so much on remittances from our overseas workers, and if they lose their jobs then not only will the remittances be severely reduced, we are also in no position to absorb the influx of unemployed workers. That makes for a pretty worrisome situation I should think.” – regulator interviewee 2009 coda

“We only have a small share of FDI. So we're not growing. The growth is not robust, so we are relying on the remittances of OFWs. The remittances are the 1% difference between GDP and GNP. The remittances are the money that's allowing people to shop. Basically, the OFWs have helped the economy to be on an even keel. We've exported our labour problem of unemployment, and not mitigated the social impact. Our labour costs are not cheapest anymore, and we are more expensive than Vietnam or Thailand.” – private sector 3

The reliance and dependence on remittances are a reflection on the lack of trust and lack of confidence in the local politico-economic system while taking advantage of the benefits of the global financial system (FT 2009) by bypassing home country restrictions. Remittances are a more effective tool for poverty reduction than foreign aid given to governments:

“When money is shipped directly to the individuals who need it the most, rather than being funnelled through corrupt and inefficiency government bureaucracy, then it can have the greatest impact.” -Woolsey (2009)

Unlike its neighbours in the region which have sought the opposite by creating a facilitative business environment, the lack of employment opportunities means the OFW phenomenon is a pitiful reflection on the failure of the country's policies to actively promote employment. Indeed the disappointment of diasporas with their home countries was touched upon by Werbner (2009: 548) and some soul-searching from one interviewee about the double-edged sword of the OFW:

“There is a problem of confidence because of the personalities involved. Who do we blame? Do we blame the private sector and corruption in government? Where do we find solutions? The option will always be in the domain of the middle class and to leave the country. It is very sad.”- private sector 4

The contribution of existing government policies in forcing people to leave the country to eke a living cannot be underestimated given the success of Filipinos to make a living overseas. The median Filipino household in the USA at US\$65700 - some \$10,000 higher than other American Asian households (US Census Bureau 2007: 4,17) Given the phenomenon of India’s ‘licence raj’ and the problems of Philippine corruption, these two countries known for their reluctance to liberalise economically have produced citizens that are most motivated in doing economically well abroad.

The lack of opportunities in their home countries that have prevented economic growth to take place have unleashed their entrepreneurial spirits abroad. There is a sense and somewhat perverse turn of patriotism in the country where current policies are reluctant to open up the country to trade, economic liberalisation and with it the inflow of foreign investment that will create jobs in the country and for its citizens. Thus, the positive economic effects of remittances have been somehow justified to actively promote the OFW phenomenon which by necessity means the break-up of families – in a society that places the family in the centre.

9.9.2 The Brain Drain

The social impact and expectations of OFWs is changing Filipino society and the structure of families. While OFWs have institutionalised the ‘*balikbayan*’ culture combining the flow of social goodwill and trade (Nonini 2005: 568), the continual drain on the populace has long-term effects:

“It’s not a good sign – this OFW phenomenon. It’s kind of like a double-edged sword. It’s keeping our boats afloat, but on the steer it’s a brain drain, families are breaking up, we’re losing expertise. It’s not because we’re creating enough jobs, there’s something more fundamentally wrong [here].” – private sector 1

“In the past we used to have a very high level of loyalty [from employees]. But now the skilled, experienced people are leaving to go overseas. [And we have to]

start all over again. All the nurses are leaving the country. There are hospitals no longer. There is on average 1 nurse for 50 patients in the provinces. The sad thing is a lot of educated people are leaving for overseas.” – private sector 2

The above comments echo Lawless’ point on the brain drain the country is experiencing and will continue to experience unless major structural arrangements are made:

“...the problem of the so-called ‘brain drain’ stems from the basic inability of the Philippine economy to absorb the domestic supply of professionals, especially physicians, scientists and engineers.” (Lawless 2005:250)

Nearly every Filipino family is affected by having a loved one or someone close to them leave for the fertile shores of another country. The self-congratulatory mode of praising those who have left overlooks the dire situation which has motivated their departure. Instead of addressing the motivations for such departure, the political machinery has sought to congratulate those who have left as if this was a somewhat sustainable and healthy self-image of country:

“The Philippine Women’s League of Japan...lambasted Philippine officials ‘for their failure to address properly the unemployment problem, politicians back home have resorted to flattering the egos of Filipino workers stranded abroad with such accolades as ‘unsung heroes’, ‘saints’ etc even when many of them are ending up in foreign jails.’ (Lawless 2005: 249)

Indeed the presence of endemic corruption is a major motivation in the brain drain as “corruption simply drives technically oriented people out of the country altogether.”(Ades & DiTella 1997: 1040) Going abroad may allow some professional OFWs to have their skills recognised and rewarded than in a country where personal connections count more. This freedom to work and promoted based on one’s merits liberates people:

“Filipinos working abroad seem miraculously released from the many deleterious labour routines and practices that restrain their energy, industry, innovation and idealism at home. In Japan they manifest an ability to work diligently and innovatively, for which they earn admiration.” (Anderson 2005: 816)

Nevertheless, the other side for the OFW means facing certain racial discrimination

(Anderson 2005: 816), a sense of self-displacement (Schiller 2005: 578) or experiencing the conditions of the modern-day trade in slavery if OFWs find themselves in a country where human rights are not so well recognised¹²².

9.9.3 Political Activism

Political activism by Filipinos abroad or in exile has had a long history.¹²³ According to Schiller, there are “four different political stances adopted by long-distance nationalists toward their homeland: 1) anti-colonialism, 2) separatism, 3) regime change and 4) participation.” (2005: 574)

During the main political upheavals in the country’s history such as the fight for independence from Spain and under the Marcos dictatorship, political exiles proliferated¹²⁴. During my research journey, I spoke with those who were politically active and who at one point or other sought exile. At the University of the Philippines and Ateneo de Manila University, plaques and memorials commemorate opponents to the Marcos regime who paid the ultimate sacrifice. I also came across the children of those who were politically active during the 1980s and they spoke of harrowing tales of their parents’ flight overseas or to the jungles of Mindanao to escape Marcos’ security forces.

The phenomenon of political activists abroad is not new and in some countries encouraged formally with a new form of transnational politics evolving (Schiller 2005: 578). In Australia, a net intake of immigrants, the country’s large Italian community has seen some of their more politically active members stand for Italian parliament (Edwards 2006). With the election of a select few members of the worldwide Italian diaspora to the

¹²²Cases of sexual exploitation and international trade in prostitution abound. While in Manila, I happened to come across an international conference held by a UN body on the latter issue. One newspaper article I came across described the slave conditions of 51 Filipinos nationals that were forcibly worked in Iraq (David 2007b). One of the more infamous cases of modern-day slave conditions was the story of Flor Contemplacion, a domestic worker who was put to death in Singapore. (see Rannveig Agunias and Ruiz 2007)

¹²³ See Lawless for a brief history of the Philippine diaspora who mentions the more interesting diasporic communities such as the St. Malo Manilamen of Louisiana in the late 19th century

¹²⁴ The country’s national hero, Jose Rizal was one of them: “Intellectuals living in Spain but with roots in the Spanish colony in the Philippines helped forge the vision of an independent Filipino nation.” (Schiller 2005: 574-575) while many of Marcos’ opponents including Benigno Aquino, lived for a time in exile in the USA: “In the third form of long-distance nationalism, activists advocate regime change. Their quarrel is not with the territorial boundaries of the state in which they live, but with the individual or political party that controls. Filipinos abroad helped overthrow the dictatorship of Ferdinand Marcos in 1986.” (Schiller 2005: 575)

Italian Senate, this new group has seen the nascent ‘political enfranchisement’ and empowerment of the scattered.¹²⁵(Panichi 2008)

Thus, in the Philippines, some now see OFWs as a light of hope for change and to trigger political reform that would address the longstanding economic and social inequality in the country:

“OFWs are creating a new subsector of the Philippine economy. The social character of the economy is the overseas family investors and workers. We rely on them so much it’s creating a subsector. They are also addressing the social justice issues. There is now this whole segment of [the country] which is getting access to education because of overseas money. [They are] not as bound to the land as before. [They are] not as bound to the old relationships. [The OFWs are] creating a new middle class after [the previous flights of] the middle class. Because of the money coming in, there is [now] a new generation that can challenge the traditional oligarchies. It’s happening. It’s not static. The fact that you have many cases of corruption [coming out], [the] cheating in election, [means society has become] much more vigilant. [They do] not accept it as a right or take it for granted.” – academic 1

A substantial middle class is also seen as the way to reduce the power of the oligarchy in the country:

“The middle class has to grow. Business has to be broader. We are still very oligarchical.” – academic 2

“The only way now to reduce the control of the oligarchs is through the strong and large middle class. There are two ways to do it: revolution or the dominance of the middle class.” – private sector

Perhaps in the near-future, the Philippines may look towards its diaspora and encourage their return and participation in the future political development of the country.

¹²⁵ However, whether this transnational political exercise is sustainable in the long term remains to be seen. The results from the first Italian government after expatriate voting did not change the chaotic, relatively short-term, insular and disruptive nature of Italian politics.

9.10 Addressing Corruption: Leadership by Example

The most effective way to address corruption and to show that it is being tackled seriously is by leadership from the top. If the leader of a nation-state behaves in a manner that is intolerant of corruption and discourages corrupt behaviour, this flows through the administration, bureaucracy, organisations and ultimately, the country and society at large. This is not an easy task. The following passages contain lessons that can be learnt from the experiences of Colombia, Singapore and the World Bank Group.

9.10.1 The Transformation of Colombia

In a 2009 Lowy Institute presentation, the American-educated Colombian Minister of Trade, Industry and Tourism, Luis Guillermo Plata, spoke about the transformation of the country in recent history. His presence in Australia was part of a whirlwind world tour seeking foreign investment for the country in essence capturing renewed investor confidence for the country (Plata 2009). For Mr. Plata, he related his family's story of departure from the country after a militant group stormed the Supreme Court of Colombia and assassinated the justices. Sick of the violence, sick of the narco-trafficking, his family left the country - a tale repeated by many others. However, in 2009, the country had changed under the reformist zeal and transformational leadership of Colombia's President Álvaro Uribe Vélez. In 2008, the rescue of a group of hostages including the Franco-Colombian politician, Ingrid Betancourt, from the Revolutionary Armed Forces of Colombia (or FARC) received worldwide recognition, domestic confidence in increased security and in its President. (McDermott 2008)

Mr. Plata noted that the recipe is simple for a country to transform: Democratic Security equals Confidence equals Investment equals Growth. (Plata 2009) In 2009, the so-called "Uribe effect" (The Economist 2007c) has seen investment as proportion of GDP at 30%, GDP growth at 3.5% and more importantly, murders continue to go down. Citing the Doing Business 2009 World Bank Report, Colombia ranked second behind Chile in terms of being the most business-friendly country in Latin America. (Plata 2009)

Colombia is also going its own way. Diplomatically speaking there are conflicts with its neighbours such as Ecuador, though they are still "brothers" in the same continent; the different economic route taken by other countries in the same continent such as Venezuela must be respected thus Colombia seeks to align itself more with bilateral

trade agreements and great economic cooperation with countries in the Pacific region. While Mr. Plata does not underestimate the continued challenges his government faces, the pro-activism shown by Uribe's cabinet shows how the political will to succeed can happen if it is encouraged and followed through.

9.10.2 Singapore's Story

Amongst interviewees, the success story of Singapore – under the leadership of Lee Kuan Yew – was frequently cited as a model that the Philippines should or ought to emulate. However, the struggles to get rid of corruption in the country have received less coverage. In his autobiography, *From Third World to First*, Lee charts the rise of the island-state from a colonial backwater notorious for its past history of piracy, into a beacon of economic development in the region.

The Singaporean success story from Lee's view was a constant battle of promoting what was good for the country and less so for self-interest. For Lee's Singapore, Confucian values that promoted economic well-being and social cohesion were emphasised, while disavowing the less savoury aspects such as nepotism and corruption to fester (2000: 647-648).

For Singaporean statesman, Lee Kuan Yew, appearing and behaving to be intolerant of corruption was a paradigm shift in the external perception of the country and a major reason for that country's transformation and economic development from a backwater colonial island to a global city-state. Previously known as a haven for pirates, Singapore's transformation did not come about because of mere luck or because the fortune of good governance gifted the country. Rather, the post-war, post-colonial geopolitics of the region meant practising a delicate negotiated process of appeasing the major powers of the time to provide a legitimate and stable political base. From this base Lee exercised extraordinary political will and determination to shape the country into one of the region's economic dynamos. This fundamentally meant tackling the internally-generated cancer of corruption as he became disillusioned with other Asian leaders who toppled their colonial masters but practised the same *lèse majesté* (2000: 157).

This burning fire of patriotism swept the region immediately after the devastations of World War Two and local political leaders incited a wave of nationalism against their European and American colonisers. Lee was one of those fervent, passionate student

leaders who matured in the post-war environment, ready to take on the mantle of leadership (2000: 158).

Lee related an environment not so dissimilar to what is present in the Philippines today: queues at airports because customs officers were asking arriving passengers for a suitable recompense for their meagre wages (this happened to the author); traffic police would stop drivers because of an alleged offence such as speeding (and indeed anyone who has travelled in peak-hour Manila would know what an achievement it is to speed); negotiated taxi fares; inducement provided at hospitals' admissions to allow an ill person to 'jump the queue' so to speak and receive prompt medical attention. Indeed the appearance and general acceptance of corrupt behaviour at the operational levels of society was - and is - indicative of a more serious systemic malaise (2000: 159).

Tackling corruption, Lee's government empowered the Corrupt Practices Investigations Bureau (CPIB)¹²⁶ which was set up by the former British colonial rulers in 1952 to deal with corruption. The effective powers of the Bureau were progressive: for petty or 'small' fish type of offences, procedures were simplified and personal discretion was removed with the publication of transparent guidelines. With major incidences of corruption, the laws were tightened in stages (2000: 160). According to Lee, the introduction of the lifestyle check (which is present in the Philippines today) assesses whether an official is living beyond one's means without reasonable legitimate explanation for how such means can be funded. This was the biggest innovation in tackling corruption. (2000: 160) Fines were increased and offences became subject to imprisonment. Organised and major corruption was now being tackled. When leaders behave in a transparent manner, this naturally flows through the levels of bureaucracy (2000: 160)

Transparency International's Corruption Perceptions Index "ranks countries in terms of the degree to which corruption is perceived to exist among public officials and politicians....where 10 is highly clean and 0 is highly corrupt." (Lambsdorff 2007: 324, 330) In 2006, Singapore scored 9.4/10 placing it #5 in the world after Finland, Iceland, New Zealand and Denmark; and above Australia (#9), UK (#11) and the USA (#20). On the other hand, the Philippines scored 2.5/10 ranking equal #121 with other luminaries such as Benin, Honduras, Nepal and Russia. (Lambsdorff 2007: 325, 329)

¹²⁶ Website of Singapore's Corrupt Practices Investigative Bureau
<http://app.cpiib.gov.sg/newcpib/user/default.aspx?pgID=21> accessed 5 March 2009

While Lee can be praised for ridding the island-state of corruption, he has been less successful in disengaging from the perception of nepotism.¹²⁷ As some interviewees pointed out, Singapore epitomises the ultimate example of a family business.

Nevertheless, Lee's crusade against corruption was successful although it had come at a tremendous personal cost to him when fellow colleagues were revealed to be corrupt. One colleague committed suicide because he had lost face when he was found to culpable of corrupt conduct and this deeply affected Lee. (2000: 163)

Lee also was damning of his fellow Asian leaders that had liberated their people from the oppression of colonialism but once they had ascended to power acted in a manner that contributed to the detriment of their societies:

“The percentage, kickback, baksheesh, slush or whatever the local euphemism is a way of life in Asia: People openly accept it as a part of their culture. Ministers and officials cannot live on their salaries to the standard of their office. The higher they are, the bigger their homes and more numerous their wives, concubines or mistresses, all bedecked in jewellery appropriate to the power and position of their men. Singaporeans who do business in these countries have to take care not to bring home such practices.” (2000: 163)

If the Philippines wishes to follow the footsteps of Singapore, corruption must be tackled by its political leaders.

9.10.3 Paul Wolfowitz's Departure from the World Bank

During my fieldwork, the local Manila papers gleefully covered the saga concerning former World Bank Group President Paul Wolfowitz's personal life. (Business Mirror 2007g, Valino 2007, Sta. Ana III 2007) As in many developing countries, pronouncements by the World Bank hold significant institutional cachet in the Philippines. Like Louis XIV's *'l'etat c'est moi'* – Wolfowitz was the Bank. This is true for any person who carries the mantle of leadership – the role, and what it represents, is above the individual.

Wolfowitz was widely reported as conducting a personal relationship with a fellow World Bank employee. The impression that his objectivity was impaired was

¹²⁷ Lee's son succeeded him as prime minister, while Lee's daughter-in-law is head of the sovereign fund Temasek (Burton 2009).

compounded when it was revealed “he had violated his contract by breaking ethical and governing rules in arranging the generous pay and promotion package” for his companion which contravened Staff Rule 3.01, Paragraph 4.02 on conflict of interest. (World Bank 2007, Weisman 2007)

The protracted departure of the august institution’s President was met with dismay. The Bank was losing credibility in developing countries the longer he stayed. Anecdotal evidence suggested staffers in World Bank offices in developing countries sorely felt the brunt of this episode. The turmoil over Wolfowitz was a chance for long time opponents, such as disempowered developing countries, to bite back at the hypocrisy:

“Wolfowitz’s relationship with Riza provided the perfect opportunity to accuse him of favouritism and nepotism, rendering him unsuitable to lecture other nations on the need to clean up their act.” (Baxter 2007)

Iteratively, the institution’s staff association noted that the action of its senior executive exposed the Bank to actions of bad faith – it chided developing countries for their lack of good governance but failed to keep its own house in order:

“Senior Management has put forward a call for good governance, both within the Bank and among our partner countries. Good governance is founded in a respect for rule of law, transparency and accountability. In order to be credible, Senior Management must model the behaviour it espouses.” (World Bank Staff Association 2007)

To be seen and to appear to be seen as practising precepts of good governance is crucial especially if you head the leading dispenser of aid and advice in countries where poor governance is a daily part of life:

“Mr Wolfowitz did not behave corruptly but he exercised exceedingly poor judgement. Bank officials did not behave corruptly but they behaved cravenly from beginning to end. It’s enough to make you want to wash your hands of the whole thing. But the bank still matters as an institution that helps the world’s poor.” (Washington Post 2007)

His departure restored the Bank’s reputation. The Bank showed its responsiveness: for the greater good of the organisation it was prepared to get rid of its discredited leader.

The signal was clear – the preservation of the institution’s integrity was bigger than one person.¹²⁸

9.11 Countering Corruption

There are two stakeholder groups in Philippine society who are promoting greater transparency and actively fighting against corruption: non-governmental organisations (NGOs) and the media. The last part of this section looks at the stance of the Asian Development Bank (ADB) in addressing and countering corruption in the country and the region.

9.11.1 Non-Governmental Organisations

Non-Governmental Organisations (NGOs) can “represent one important path through which macro-scale societal changes can lead to micro-scale political reforms” (Xin and Rudel 2004: 306) According to Whaites (1998) where there is a weak state, there is a relatively strong civil society. While the public sector in the country is disempowered, the third sector in the Philippines is vocal and active. According to Domingo, NGOs have a long history in the country going back to Spanish colonial rule and they are “one of the most vibrant in Asia.” (2008: 277)

In an International Finance Corporation (IFC) backed report which scrutinised the prevalence of socially responsible investments in the Philippines, the country is said to “benefit from a huge third sector NGOs, people’s organisations (POs) and cooperatives who work to raise awareness and conduct projects” on environmental and community awareness (ASRIA 2003: 10-11). Furthermore, “The Philippine case is unique in that many CSOs are really voluntary organisations of a wide array, covering very diverse groups with different natures, agendas and historical contexts.” (ASRIA 2003: Appendix 1)

It is estimated that the country’s non-profit sector “vary from 60,000 to almost 96,000 registered non-profit, non-stock corporations... [in addition to] 35,000 cooperatives registered with the Cooperative Development Authority (CDA). These figures do not

¹²⁸ In response to the Wolfowitz a Section B No.6 of the Code of Conduct for World Bank Group Board officials was updated in November 2007 to explicitly state what constituted a conflict of interest
<http://siteresources.worldbank.org/BODINT/Resources/CodeofConductforBoardOfficialsDisclosure.pdf> accessed 10 March 2008

include the...undetermined number of unregistered organisations. Recent estimates suggest that while many civil society organisations operate on relatively small annual budgets of less than P2M, there are also a few big NGOs (also known as BINGOs) and foundations with annual budgets of P30M and above.” (ASRIA 2003: 11)

Español highlights the importance of many active civil society organisations in the country that are advocates for change. Non-governmental organisations (NGOs) such as the Transparency and Accountability Network (TAN) and Transparency International Philippines (TI Philippines) are important in fighting judicial corruption as they “play crucial roles in scrutinising and enhancing judicial accountability.”(2007: 262)

For the influential private sector lobby group, the Makati Business Club, the fight against corruption means funding projects that tackle this issue through a network of NGOs, volunteers and people’s organisations. Tackling the legislative process to make effective changes in the country is akin to handling “an elephant” therefore, from the group’s perspective, grassroots movements are more effective in improving transparency.

Aside from supporting the boys’ scouts to tackle textbook ghost deliveries (see section on Low level opportunistic pay-offs), MBC supports the National Citizens Movement for Free Elections (NAMFREL) which is a volunteer group that monitors elections. MBC finds it encouraging that there is already an active citizenry and that they need only be galvanised to act:

“We walk the talk. It’s not our specialisation. We work with NGOs; we work on the community level. In villages, we have the Church watching how government revenues are spent. We are building up a movement on the grassroots level that is a counter-corruption culture. They’re idealistic and are ready to do it. We provide training, *merienda* [tea], capability and capacity building, so they can learn the process.”-MBC

The success of the grassroots movements was commented upon by one interviewee:

“There are more grassroots groups watching the pork-barrelling of expenditures of congressmen. For example, on infrastructure, the groups discovered roads not built to specifications. There are two missing roads.” -private sector

As an example of NGO activism (with backing from religious and business groups), after the 2007 elections, a full page ad appeared calling for “Reform for our electoral system now!” in the Philippine Daily Inquirer¹²⁹. The ad stated:

“Despite the many flaws in the process and administration of the May 14 elections, it appears the popular will of the electorate was generally able to manifest itself in the final results of the election. Much of the credibility in the outcome can be attributed to the courage of the media in reporting anomalies in spite of personal risks to the reports and to the vigilance, volunteerism and coordinated action of the citizenry.

"Unfortunately, the same cannot be said of COMELEC, whose lack of political will and determination to safeguard the electoral process contributed to the proliferation of electoral fraud, election-related violence, voter disenfranchisement, irregularities in procedure and other anomalies that degrade the character of Philippine democracy."-PDI ad

The ad was funded by a heterogeneous group which included the Bishops-Businessmen's Conference for Human Development, Cebu Business Club, Financial Executives Institute of the Philippines (FINEX), Management Association of the Philippines (MAP) and MBC. The ad further commended the following NGOs for their role in the elections: NAMFREL, National Secretariat for Social Action (NASSA), Parish Pastoral Council for Responsible Voting (PPCRV), Simbahang Lingkod ng Bayan (SLB), Catholic Media Network and the Legal Network (LENTE).

The Philippines has nurtured a strong civil society (symptomatic of a weak government) at times filling in the gap where public services should be available for the populace. But they are not - and can never be - a substitute for a strong, legitimate state. (see Whaites 1998: 344)

9.11.2 Media

Compared to the rest of the region, the Philippine media is relatively free. A frequent user of libel suits, Singapore's Lee Kuan Yew is derisive of this “free media”:

¹²⁹ Full page ad ‘Reform our electoral system now’ (2007) Philippine Daily Inquirer, 20 July, Friday

“Western liberals have argued that a completely unfettered press will expose corruption and make for clean, honest government. Yet uninhibited and freewheeling press and television in India, the Philippines, Thailand, Taiwan, South Korea and Japan have not stopped the pervasive and deeply embedded corruption in these countries...” (2000: 166)

Nevertheless, the Philippine fourth estate plays an important role in exposing corruption and “a new breed of investigative journalists, seemingly fearless in their desire to expose corruption, emerged after the country’s transition back to democracy.” (Hutchcroft 2008: 143)

One beacon, the Philippine Center for Investigative Journalism¹³⁰ is highly regarded.¹³¹ A free, independent and effective media can be a powerful deterrent to corruption (Huther & Shah 2000: 4):

“Freedom of speech and a free press are generally considered important human rights and powerful controls against government malfeasance. An independent press is probably one of the most effective institutions to uncover trespassing by government officials...and an important check on corruption.” (Brunetti and Weder 2003: 1801, 1821)

Some of my interviewees understood this advantage and liability:

“We have bad press because we’re free. You read the tabloids because the issue of corruption.” – private sector 1

“I get panicky if I receive a query from Fitch, Standards and Poor’s at 8:30am over an article in *Business World*, and I must reply by 9am” – private sector 2

“The press is a constant watchdog and is at your back. It’s easier to implement transparency, accountability [when they are there].” – public sector

And the importance of the media in preserving the democratic space:

“You have Filipinos who want to reform the state and build capacity. It still makes a difference if it’s not an authoritarian regime. [The Philippines] is not a

¹³⁰ <http://www.pcij.org/> accessed 23 March 2009

¹³¹ At a pre-departure briefing with a representative from an international financial institution, he suggested that my first port-of-call should be the PCIJ.

genuine democracy but it is not authoritarian either. There are human rights violations but still it is different – there is a freer media now. I lived through the Marcos years - our own office (at the university union) was raided by the military. There's some democratic space and we need to maintain that democratic space.”
– academic

Nevertheless, the media for all its ills, *chismis* (gossip), parochialism and nationalism (sometimes coupled with xenophobia), the journalists in the country have shown “that beneath the rule of men entirely great, then pen is mightier than the sword.”¹³² The profession of journalist remains highly risky in the country with 62 murders of reporters in the 7 years leading to 2008 (International Federation of Journalists 2008: 2) and the worst massacre of the profession during peacetime with some 30 journalists killed in Maguindanao Province, Philippines in late 2009 (CPJ 2009).

9.11.3 Asian Development Bank

International financial institutions and multilateral agencies play an influential and important role in most developing countries. They provide long-term loans to heavily indebted governments and are a link to the outside world of financial global players.

The Philippines, which has hosted the headquarters of the Asian Development Bank (ADB) since 1966, is one of these countries¹³³. While most of East Asia has managed to transform themselves from largely agrarian producers to industrialised exporting manufacturers, the Philippines has been left behind.

For the ADB, whose *raison d'être* is a smaller version of a regional World Bank, the country's existing political environment has given it an uneasy existence with its host country. Not so long ago there was discussion that the ADB should move its headquarters to some other Asian country, preferably on the continental Asian land mass.

The ADB compound is in Ortigas, one of the CBDs that form Metro Manila. It is a heavily secured compound almost to the same level as the American Embassy. It is an

¹³² Attributed to Edward Bulwer-Lytton from his 1839 play, *Richelieu* <http://www.bartleby.com/100/427.4.html> accessed 23 March 2009

¹³³ ADB (2009) About ADB: History, <http://www.adb.org/About/history.asp> accessed 2 March 2009

intimidating fortress to deter detractors who would wish to do physical harm on what the institution represents. Inside, however, are dedicated, idealistic and frustrated people who more than anything – would wish that their host country lift itself out of poverty. Inside one of their boardrooms is a floor to ceiling poster: “A Philippines free of poverty.”

The ADB’s objective: to lift the most populated part of the world out of the depths of poverty – has largely been met in East Asia. Except for the Philippines. In some ways this is a sad reflection that the country that hosts the regional economic development bank should be the least developed.¹³⁴

In September 2007, the ADB President Haruhiko Kuroda paid a visit to Sydney’s Lowy Institute for International Policy (Lowy Institute 2007). Below is the public exchange I had with him on corruption in the country and his response on the institutional boundaries the ADB has when it comes to addressing corruption in the Philippines:

“Question: Mr. President, Marie dela Rama, University of Technology Sydney. I have just spent 4 months doing corporate governance research in Manila. One of the biggest problems facing the country is corruption which is endemic. Not only is it endemic, it is the unpredictability of corruption there that is deterring both local and foreign investment, and hence employment and growth.

“For foreign investors, one of the obstacles is the foreign ownership limits in the critical area of infrastructure. As you are well aware, the new Terminal 3 of Manila’s international airport was completed 3 years ago but remains unopened due to disputes between the government and the foreign investors. The terminal is a symbol of the country’s development quagmire. What is the Bank doing to address such problems as these in places like the Philippines and elsewhere? Thank you.

“Response: The economy of the Philippines has improved, the quality of its performance, growth rate which is at 6 or 7%. It is not high compared to China’s 9%. But it is one of the highest in the region. Not only in growth but inflation is significant at 2%. The Philippines used to be one of the high-inflation countries. Its fiscal deficit is 1% with a 45% current account surplus due to remittances. The macroeconomic conditions have greatly improved. Alas, the microeconomic environment for investment has not

¹³⁴ The ADB has published a fact sheet on its presence and relationship with the Philippines http://www.adb.org/Documents/Fact_Sheets/PHI.pdf accessed 3 May 2010

significantly improved in recent years. FDI has improved for example in the minerals sector due to global commodity prices.

“On government and corruption: as aptly described, corruption’s unpredictability is hurting the country. The ADB needs to help fight corruption in 2 ways:

1. Increase effective sector-specific governance improvements with the World Bank Group. Reform the power sector - as you know electricity costs is too high, extremely high. These are problems under governance. The ADB and the World Bank can help government improve power through program loans. This is a very important component of the governance agenda. Other sector specific governance [approaches undertaken in other countries include] India, Pakistan, Bangladesh, Vietnam. In sector specific governance improvement – we have hope with that. The sector-specific approach [we] hope to be successful. The countrywide assistance by the ADB and the World Bank has not always been so successful [but on the] sector specific approach as in power – we have provided.
2. Managing the judicial system. The judicial system is not famous for efficiency and effectiveness. With assistance this might be improved.

“Corruption and governance issues have many facets. At the end of the day, it must be squarely addressed by the government and people rather than external multilateral institutions. We hope that governance can be improved not only in the Philippines but also in the rest of Asia. This is very important.”

The ADB is a seat of influence but does not intervene in domestic affairs. The organisation has found it difficult to address this issue in a country whose leaders are deaf to criticisms especially on the systemic, unpredictable and endemic nature of corruption which poisons, guts and abruptly retards the economic growth of the nation.

9.12 Corporate Governance and Corruption

As the most important emergent theme of my research, in this chapter I have discussed the different varieties and ways corruption affects the business environment and the implementation of corporate governance reforms in the country. However, the exploration has been limited and nascent. Further research is required to explore the

following questions: what role does corporate governance play in a corrupt environment?

The people I interviewed were the most enthusiastic supporters of corporate governance. While not the silver bullet to cure the ills of the country, introducing corporate governance is a major paradigm shift in a business environment which thrives on opacity. Corporate governance is seen as an external force in enhancing private sector development. Foreign investors demand corporate governance, and local firms cannot expand without the addition of foreign capital. Therefore, corporate governance practices need to be supplied. By increasing transparency, accountability and improving disclosure, these governance tenets also address corruption:

“Corruption is very narrow and is a short-term perspective. In the long term, corruption is also bad for the private sector. In the short-term there is rent-seeking. Part of the pressure in the private sector is the need for foreign capital. Part of that pressure is to add corporate governance mechanisms consistent with Western standards. There is a realisation that global and foreign capital demands corporate governance standards. [These standards] moves them [private sector] in that direction.” – academic

This sentiment is echoed by Sullivan in his 2009 treatise, “The Moral Compass of Companies Business Ethics and Corporate Governance as Anti-Corruption Tools”:

“The private sector can be a force in developing solutions to the corruption problem, and companies around the world are taking charge. They are doing it in a multiplicity of ways. Some engage in collective action to reform the business climate to make it more transparent. Others push for ethical standards and fair practices in dealing with the government, as is the case with industry initiated integrity pacts. These private sector solutions to corruption however are not only external in nature and so many companies are also beginning to look inside, seeking ways to ensure that they are not unwittingly contributing to the climate of corruption. One way of addressing this dilemma and others is the establishment of strong corporate governance. It is increasingly emerging not only as a tool that increases efficiency, improves access to capital, and ensures sustainability — it is also emerging as an effective anti-corruption tool. Simply put, on the day to day transaction level it makes bribes harder to give and harder

to conceal. At the decision-making level, it injects transparency and accountability, so that it is very clear how decisions are made and why.” (2009: 2)

In turn private sector development is crucial in addressing poverty. This development cannot occur unless corporate governance becomes a norm and is part and parcel of doing business in the country. The following passage from an interviewee links the practice of good corporate governance to poverty reduction:

“I hope it [corporate governance] would ultimately impact on poverty and development. The biggest antidote to poverty is jobs. For more jobs, there needs to be more [independent] companies operating more [corporate governance; accountability]. The flash and pan companies do well but in the end they don’t contribute to the economy. It is stable, better governed companies, that would increase profitability, increase stability, increase opportunities to address case of poverty.

“It’s a chain, you have [good corporate governance] in companies, companies create jobs, jobs are the antidote to poverty. That’s the direction we’re headed. In the Institute of Corporate Directors and Institute for Solidarity in Asia, we’ve been able to help and develop a roadmap for Philippine business. For the roadmap, we have aimed to be global, responsible citizens and ethical.

“An expression of this vision is to help the country address these issues. Corporate governance is one way of bringing this about - to make us competitive. More FDI means we’re able to bring in FDI because of confidence in the system, increase jobs, decrease poverty. It’s crucial because a third of our people live like animals.” –Rex Drilon

If the value of corporate governance reforms can ever be assessed in the country, it will be their contribution in addressing corruption, improving private sector development and alleviating poverty in the country. How corporate governance contributes to lessening poverty in the country ultimately will be the judgement of the reforms’ effectiveness.

CHAPTER 10: CONCLUSIONS AND RECOMMENDATIONS

“Repression can take many forms, and too many nations, even those that have elections, are plagued by problems that condemn their people to poverty. No country is going to create wealth if its leaders exploit the economy to enrich themselves or if police can be bought off by drug traffickers. No business wants to invest in a place where the government skims 20 percent off the top or the head of the Port Authority is corrupt. No person wants to live in a society where the rule of law gives way to the rule of brutality and bribery. That is not democracy - that is tyranny, even if occasionally you sprinkle an election in there. And now is the time for that style of governance to end. In the 21st century, capable, reliable, and transparent institutions are the key to success -- strong parliaments; honest police forces; independent judges; an independent press; a vibrant private sector; a civil society. Those are the things that give life to democracy, because that is what matters in people's everyday lives.”

– USA President Barack Obama’s Address to the Parliament of Ghana (2009) ¹³⁵

The Philippines is a wonderful country. She is the pearl of the Pacific. However, she has many challenges ahead of her. Her people are crying out because of the poverty and the corruption. What does corporate governance mean for the country if it does not improve the quality of life for the majority of her people? As President Obama stated in his speech to the Ghanaian parliament, the time has come for “capable, reliable and transparent institutions.” Corporate governance reforms are a way for such institutions to exist in the Philippines. The tenets of corporate governance and its emphasis on transparency and accountability are the foil to corruption and irresponsibility. A state has no public confidence if its institutions are corrupt. A company has no legitimacy if it is irresponsible. This is the main contribution of my research – my research findings support strong public institutions to facilitate strong private sector development. The two go hand in hand.

¹³⁵ Address by US President Barack Obama to Parliament of Ghana, 11 July 2009, Accra International Conference Center, Ghana http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-to-the-Ghanaian-Parliament/ accessed 13 July 2009

10.1 Recommendations: Implications of the Research for Policy and Practice

In August 2007, I was asked to present to the Ayala Group of Companies comparing and contrasting Australian corporate governance with Philippine corporate governance. At the end, I had three slides on the future of Philippine corporate governance and what my research meant for policy and practice. I believe what I said then still remains relevant at the time of writing.

The first slide looked at what needed to be done to improve corporate governance processes. They are:

- Instil confidence in the country's economy.
- Continually support and strengthen the reforms in corporate governance regulatory institutions.
- Rethink whether importing SOX is the best way for Philippine corporate governance. Consider a principle based approach instead of a prescriptive based one. Joint PSE & ICD (and other interested advocacy groups) initiative to develop Principles for the Philippines. Principle-based reforms can complement current black letter law requirements but would prevent a total black letter law approach.
- Enforcing existing legislation is already difficult. How will a Philippine SOX be enforced?
- Increase the foreign ownership limits to a majority interest especially in the infrastructure areas.
- Improve the judicial processes in the country
- Review the political appointment system
- Increase transparency in areas of public-private interaction
- All GOCCs to have their own Principles of Corporate Governance.

The next two slides looked at two scenarios for the Philippines – firstly, if there is inertia; secondly, if the reforms continue. For the worst case scenario I had as follows:

- Resources continue to be used inefficiently
- Regulatory institutions wracked by internal politicking and vested interests. Resources for these institutions are diverted. Lack of confidence in institutions continues to paralyse development.

- Justice continues to be delayed; justice continues to be denied
- Corporate governance stalls and remains the domain of the few corporations that 'rise above the legal environment'
- Private and public sectors wracked by unpredictable corruption. The dysfunctional weak state continues.
- Political risks of coups, revolutions.
- Cycle of poverty, corruption, the Filipino diaspora and underdevelopment continues
- There is despair.

For the better case scenario I had as follows:

- Resources are being used for their intended purpose.
- Regulatory institutions are strengthened. Political support is received.
- Judicial reform is apparent.
- The practice of corporate governance becomes the norm and spreads to ALL listed companies and is encouraged in the unlisted ones.
- Unpredictable corruption becomes predictable. Predictable corruption is scrutinised and is deterred.
- The state becomes functional; less weak and less prone to threats of coups and revolutions.
- A new cycle brings investors and creation of employment; poverty and hunger decreases. The Filipino diaspora trickles.
- There is hope.

The above bulleted lists are nothing new. They were the outcome of my interview data. This is what my interviewees wanted to see in the Philippines – a better, more robust country that could finally economically integrate with the rest of Asia.

Corporate governance reforms aren't superficial despite their external imposition. The introduction of these reforms are exposing institutions and firms to standards of behaviour that believe and emphasise a more transparent way of doing business and

detering unseemly and opaque behaviour. However, as repeated often enough in this thesis, these reforms have been implemented in consideration of the existing business environment which is difficult, problematic and challenging for anyone doing business in the country.

10.2 Contributions to Knowledge

This research was motivated by the overarching question:

**What is the impact of post-1997 corporate governance reforms in
Philippine institutions and Philippine firms?**

The simple answer to my research question is: the impact was extensive.

My ethnographic approach allowed me to chart the extensive impact of the reforms on regulators and firms. In so doing, this also allowed me to document the limitations and weaknesses in introducing and imposing these reforms in both form and substance, while exposing the importance of the pre-existing environment in the operation of these reforms.

This research managed to chart the impact of external reforms and its effects on those who were directly affected by them: the individuals who in their capacity as regulators or private sector representatives who had to impose them – in the case of the former – and to comply with them – in the case of the latter.

This section briefly discusses each chapter's particular contribution to knowledge while each results chapter in this thesis contribute to the development of existing theory.

Chapter 2: Literature Review

This chapter looked at three main sources of corporate governance literature: introduction of reforms, corporate governance theories of the firm, and the general business environment. The first was specifically on how the reforms were introduced, while the latter two discuss the external and internal factors of corporate governance reforms.

Chapter 3: Methodology

My ethnographic approach in this research combined deductive and inductive inquiries both in the hypothesis development and testing and in collecting data mainly through interviews and media articles. On data collection, I have given an insight into how I managed to access my sample of interviewees contributing to elite studies while my data analysis showed my pre-occupation with node saturation. In the use of the NVivo computer program as the principal data analysis.

Chapter 4: Business and Corporate Governance Environment

This chapter contributes to existing knowledge of culture and institutional theory. Extending on Hofstede's collectivism, my research findings pointed out that its polarity - exclusivity - also go hand in hand in a stratified culture like the Philippines. Similarly, the limitations of institutional isomorphism are also exposed - there are unintended consequences when there is coercive and mimetic isomorphism. Indeed, in the Philippines corporate governance regulators were negatively affected by the imposition of the World Bank's ROSC. Another contribution to isomorphism was the need to legitimise corporate governance reforms by co-opting local players. Eventually, corporate governance reforms have been moulded to suit the environment locally. This chapter also tested hypotheses 1 and 2 which were supported.

Chapter 5: The Regulators

This chapter contributes to existing knowledge of institutional isomorphism and highlights the detrimental effects of politicisation in government organisations. This chapter also provides an insight into the resources of each regulatory organisation and their capacity to enforce existing laws. Hypotheses 1 and 2 were also supported in this chapter.

Chapter 6: Business Groups – The Owners of Companies

This chapter contributes to existing knowledge of business groups and business families. In particular, this chapter contributes to business group development as a factor to counter a weak, authoritarian or predatory state. While my research findings disproved traditional agency theory and unequivocal lack of support for hypothesis 3, this chapter did make a substantial contribution to knowledge to another corporate governance

theory of the resource-based view of the firm and the macro-organisational perspective of resource dependence theory. The results in this chapter reveal the use of the conglomerate ownership structure by business groups in a predatory or weak state is way to counter the latter's inclination to expropriate. On business families, the research findings in this chapter support existing literature on the common challenges faced by family businesses: succession, financing, professionalisation of management and the inherent relationship the family has with the business.

Chapter 7: The Board and Management – Controllers of the Company

This chapter looked in-depth at the board structure of a company. It contributes to current understanding and knowledge of boardroom dynamics while new knowledge has been generated on the profound impact a particular Western corporate governance reform, that of the independent director, has had on Philippine corporations. Similarly like its twin 6A, hypothesis 2 was supported while hypothesis 3 was disproven.

Chapter 8: Government Financial Institutions

This chapter documented the detrimental effect politicisation has on government institutions. This builds upon findings in Chapter 4 but this chapter gives specific examples of the long-term effects of undue influence by the executive on the bureaucracy. Hypothesis 1-3 were tested in the DBP section of this chapter; similar to other results in the previous results chapters, both hypotheses 1 and 2 were proven, while hypothesis 3 was disproven.

Chapter 9: Corruption

This chapter contributes to existing knowledge of corruption and provides evidence of how anathema it is to all private sector players I interviewed. This chapter also points out a corrupt environment deters and repels some investors but attracts others who are willing to engage in unethical behaviour. Corruption is a cancer in the country and this chapter charts its extensiveness and its lingering influence in the functioning of the business environment in the country.

10.3 Limitation of this Research

The main limitation of this research is that I did not interview the political elites who

control the Philippine Congress. I interviewed the business and bureaucratic elites but not the politicians. It never really occurred for me to do so and I had no appetite to interview them. In one informal gathering, one interviewee stated that I should speak to them, and my response to it was along the lines, of what is the use as I doubt I would change their minds very much. I explained that if I were a politician and would take trips overseas and see the livelihoods of millions of my fellow citizens as OFWs, I would be ashamed of myself that I did not do more for my people – that I have not given them more opportunities and reasons to stay in the country and to help economically develop the country rather than encouraging their flight.

Indeed, this limitation gives rise to bias where most of my data generated was critical against the politicians that run the country. Future research may look at the way political elites and their actions have an effect on corporate governance in the country to overcome this limitation and bias.

10.4 Concluding Remarks

Since collecting my data in 2007, the Philippines has elected a new President, Benigno “Noynoy” Aquino III, the son of Corazon Aquino - who ascended to the presidency in the wake of the Marcos dictatorship - and Benigno Aquino Jr. the assassinated senator and Marcos’ most vocal opponent. President Aquino campaigned on the stance of “*Kung Walang Corrupt, Walang Mahirap*” (If there is no corruption, there is no poor).¹³⁶ His administration inherits the challenges of an oligarchical political elite and a heavily politicised bureaucracy. However, they are not unsurmountable. The problems in the Philippines are not uncommon nor are they are unique. They are solvable and the solutions are waiting to be implemented. It rests on the imprimatur of political leadership and the will to see these reforms through to finally address these challenges.

This thesis described a sliver of the business context in the Philippines and I demonstrated how corporate governance reforms were introduced, adopted and implemented in institutions and firms in the Philippines. Corporate governance in the country, like its institutions, is a work in progress.

¹³⁶ From President Aquino’s Twitter page <http://twitter.com/noynoyaquino> accessed 2 July 2010

APPENDIX 1: INTERVIEW QUESTIONNAIRE

My interview questionnaire was semi-structured and open-ended for both sets of interviewees. For company interviewees, the questionnaire was structured around specific categories: East Asian Crisis, Ownership and Control, Impact of China, Regulation and Government, Communication and Disclosure, Shareholders and Stakeholders, Chairman and CEO, The Board, Culture and Other (which asked for other comments and their perspective on the future). For non-company interviewees, most gave an opening statement on how they saw the role they played in Philippine corporate governance and questions were modified or omitted accordingly.

East Asian Crisis

1. How did the East Asian crisis impact the corporate governance of your company?
2. Have major corporate governance taken place in the company since 1997?

Ownership and Control

3. What percentage of the company is owned by a dominant family and who are the other major shareholders? E.g. institutional investors, foreign investors, other.
4. If family-owned company: What are the advantages and challenges for being a largely family-owned company?
5. Do the major shareholders play a role in the day to day management of the company?

China

China's growth has an enormous effect on the economic health of the region and the world's. However, the system of corporate governance in China is different due to the ownership structure of the country's state owned enterprises.

6. Is your company currently involved with Chinese SOEs through joint ventures etc? If the answer is yes, what are the corporate governance challenges that the company has faced?
7. What is the company's view of a growing China and its effect on the Philippines?

Regulators and Government

8. Do you believe that Philippine government institutions dealing with corporate governance have been effective?
9. Do you have any suggestions or improvements for government institutions so that they can enhance the corporate governance environment in the Philippines?

Shareholders

10. How do you communicate with shareholders?
11. What kind of shareholder rights exists in the company?
12. Does the firm emphasise shareholder value? How does the company balance its short-term vs. long-term shareholder value needs?
13. Does your organisation have minority investors or foreign investors? Do they have any say in the functioning of the company? If they have any concerns, what is the procedure?

Stakeholders

14. Which groups are your major/minor stakeholders?
15. What is your opinion of your stakeholders?

Disclosure

16. How and when does the company disclose sensitive company information?

The Board

17. In Anglo-American countries, there has been increased emphasis on the separation of the role of Chairman and CEO. In your company, the role of Chair and CEO is combined/separated; what are the reasons for the combination/separation?
18. How are board members appointed to the board?
19. How does the board monitor management?
20. What role does the board play in providing strategic guidance?
21. Are there any independent directors on the board? How are they nominated?
22. How is the board accountable to the company and its shareholders?

Culture

23. In your view, what are the specific elements of the business culture in the Philippines that influence the formulation and implementation of corporate governance?

Other

24. What other comments would you like to make regarding the corporate governance environment of the Philippines?

THANK YOU FOR YOUR TIME AND RESPONSES.

APPENDIX 2: LIST OF ORGANISATIONS INTERVIEWED AND PARTICIPANTS

I am profoundly grateful to representatives from the following organisations that I interviewed or participated in this research:

Private Sector

A. Soriano
ATR Kim Eng
Ayala Corporation
BenPres Holdings
Blue Cross
Chemrez/D&L
Dun and Bradstreet Philippines
Far Eastern University
Irving Ackerman and Co.
Lazbertiu and Associates
Ortigas and Co.
Manulife
Metrobank
MRM Studios
Petron
PLDT
Philippine Stock Exchange
SGV
SM Investments
Wallace Forum

Government

Bangko Sentral ng Pilipinas (Central Bank)
Development Bank of the Philippines
Government Service Insurance System
Securities and Exchange Commission
Social Security System

Other Organisations

Asian Institute of Management
Asian Development Bank
Ateneo de Manila University (various schools and departments)
Corporate Governance Institute of the Philippines
Makati Business Club
Management Association of the Philippines
Institute of Corporate Directors
Institute of Internal Auditors
University of the Philippines, Diliman

And other organisations and individuals who wished to have their anonymity preserved.

APPENDIX 3: EVENTS AND INFORMAL MEETINGS

This table documents the events and informal settings I attended during my field trip in Manila from May-September 2007. Attendance of these gatherings contributed to better understanding and contextualising of my research.

Date	Event	Notes
May 30 th	Institute of Corporate Directors Annual Dinner	Speeches made by Netherlands Ambassador to the Philippines, Philippine Stock Exchange Chair; networked and managed to set up interviews as a result
June 13 th	Australia-New Zealand Chamber of Commerce (ANZCHAM) Monthly Membership Meeting	Networked and met up with Australian-Kiwi expatriates. Speech by Australian-Kiwi ambassadors on economic prospects and bilateral relationship between Philippines and ANZ. Introduced by ANZCHAM President to Australian Ambassador; set up interviews as a result of meeting.
June 15 th	Management Association of the Philippines (MAP) Corporate Governance Workshop	Attended all-day workshop on corporate governance. Most attendees were from the small-medium sized enterprises of the country. Managed to set up interviews as a result of introducing myself to speakers at the workshop
June 21 st	Joint MAP and American Chamber of Commerce (AMCHAM) Monthly Members' Meeting	Attended meeting of joint MAP-AMCHAM meeting with guest speaker was then American International Group (AIG) Global CEO Martin Sullivan. Introduced myself briefly to him and asked a question from the floor on his views on corporate governance. Networked and introduced myself to others.
June 25 th	Informal meeting with private sector interviewee	Post-interview meeting with private sector interviewee. We discussed further issues as a result of the interview.
July 3 rd	Informal meeting with development bank representatives	Informal meeting with development bank representatives to discuss the state of the country from their perspective.
July 4 th	Informal meeting with wife of a former Philippine ambassador to the USA	Informal meeting with a friend's friend who is the wife of a former Philippine ambassador to the USA. She spoke about the state of the country and the

		impact of the Marcos dictatorship. Coincidentally, I had introduced myself to her husband at the June 21 st MAP-AMCHAM meeting and our paths were to cross again as he sat as a board member of an organisation I interviewed.
July 10th	ANZCHAM Monthly Members Meeting	Further opportunity to meet, greet and network with expatriates in the country. Guest speaker was Finance Secretary Margarito Teves. Asked him a question from the floor on corruption in the country. Spoke to a number of people employed by Australian companies with local subsidiaries in the Philippines.
July 21st	ANZCHAM Bledisloe Cup Event, Australian Ambassador's Compound	Attended the showing of the Bledisloe Cup (an annual traditional rugby match between Australia-New Zealand) that was held at the venue of the Australian Ambassador's compound. High security to access that part of Makati. New Zealand won. The Kiwi ambassador was happy.
July 23rd	Informal gathering at the Institute of Philippine Culture (IPC), Ateneo de Manila University	Farewell lunch to administrator at the IPC. Introduced myself and networked with fellow academics.
July 27th	Informal gathering with private sector interviewees	Post-interview meeting with private sector interviewees to discuss further the state of corporate governance in the country.
August 9th	Informal gathering with private sector interviewees	Post-interviewee meeting with private sector interviewees discussing research.
August 14th	ANZCHAM Monthly Members Meeting	Last opportunity to meet, greet and network with expatriates in the country. Guest speaker was former SSS commissioner and CEO of then AIG Philippine subsidiary, PhillamLife Jose Cuisia.
August 16th	Informal gathering with Australian embassy representative	Informal meeting with Australian embassy representative from the Department of Foreign Affairs and Trade (Austrade) to discuss my research progress.
August 21st	Informal gathering with representatives from development bank and private sector	Brought together people I had met during the course of my interview, in particular brought development bank representative to meet up with some private sector interviewee and representatives

August 23rd	Presentation to private sector group	Presentation on corporate governance to the Ayala Group of Companies comparing Philippine corporate governance with Australian corporate governance.
August 27th	Informal gathering with private sector interviewee	Informal meeting with private sector interviewee to discuss research.
August 30th	Informal gathering with private sector interviewees	Organised an informal gathering bringing together different private sector interviewees and representatives to meet and greet each other.
September 3rd	Informal gathering with private sector interviewees and representatives	Farewell lunch. Departed for Sydney the following day.

In Sydney

September 13th	Lowy Institute Distinguished Speaker Series	Guest speaker was Mr. Haruhiko Kuroda, President of the Asian Development Bank (ADB) and Chair of the ADB's Board of Directors. Asked him from the floor a question on corruption in the region.
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APPENDIX 4: LIST OF MEDIA ARTICLES COLLECTED AND ANALYSED BY PUBLICATION

Business Mirror

Friday-Saturday, 18-19 May 2007 Vol. 2, No.424

de Leon, Max V.: Foreign chambers plan first joint jobs fair, say labour crunch hinders expansion, p.A1
Gonzalez, Mia M.: After 7 years, JP Morgan Corporate Access Days is back, pp. A1, A4
Palace holds Ong's SC posting; JBC probes, pp.A1, A5
Isla, Paul Anthony A.: Power sector to have open access, retail competition
Hot money inflows increase 40% in April, p.A8
Balaba, RM: View China as opportunity, not a threat, p.A8
de Leon, M.V.: GMA eyes deal with BHP Billion, p.A8
Jimenez, C.: Forwarders bungle job for COMELEC, p.A8
Investors/jobs expo, pp.A1, A8
Editorial: Development and the private sector, p.A10
Editorial: World-class mess, p. A10
Valino, Raul.: Don't cry, Wolf; Riza won't resign, p.A11
Gagni, Lito U.: Fraport's Achilles heel, p. A11 - NAIA Terminal
Cartoon by Albano

Monday, 4 June 2007 Vol. 2, No.435

Balaba, R.M.: Despite crisis, globalisation's impact, East Asia keeps rising, pp. A1, A4
BSP is GSIS-SAGA Awardee, p.A2
Editorial: Growth should uplift the poor, p.A6
Acosta, R: Ombudsman wants lawyers probed p.A8
Enhanced financial literacy in the college level, p.C2

Wednesday, 6 June 2007

Tort, Marvin A.: Sustaining economic growth, p.A7

Monday, 18 June 2007

Quimpo-Espino, Margie: Koreans invade the Philippines - not all good news accompany their increasing number, pp.B2-1, B2-2
Lacorte, Germelina A.: Korean businesses are bullish in Davao: investing millions in real estate, tourism projects. p.B2-2
Cabreza, Vincent & Moulic, Gobleth: Who's afraid of Korean businesses in Baguio - Records show only 10 have working visas but...p.B2-3

Tuesday, 19 June 2007, Vol. 12, No. 446

Vallecera, Jun: RP Trading costs too high - WBG - Customs bureau's new impositions for scanners worsened business woes, p.A1, A5
Bloomberg: RP share sales may reach a record P80B.
Jimenez, Cher & San Juan, Joel: Breastfeeding champions step up call on eve of hearing, pp. A1, A4
AP: Globe tower attacked, p. A8
Cabuag, VG: Shipping official accused of theft, C4

Friday-Saturday, 3-4 August 2007

Tort, Marvin A.: Back to step one for North Harbour,

Editorial: Treasure map, p.A10

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APPENDIX 5: SEC REQUIREMENTS FOR A COMPANY DIRECTOR AND AN INDEPENDENT DIRECTOR

The first column lists the requirements of an ordinary director while the second column contains of who can/not be an independent director.

SEC Code of Corporate Governance II The Board Governance¹³⁷	SEC Securities Regulation Code (SRC) Rule 38 – Requirements on Nomination and Election of Independent Directors¹³⁸
<p>4. Qualifications of Directors Every director shall own at least one (1) share of the capital stock of the corporation of which he is a director, which share shall stand in his name in the books of the corporation. The Board may provide for additional qualifications of a director such as, but not limited to, the following:</p> <ul style="list-style-type: none"> a. Educational attainment b. Adequate competency and understanding of business c. Age requirement d. Integrity/probity e. Assiduousness <p>5. Disqualification of Directors The following shall be grounds for the disqualification of a director:</p> <ul style="list-style-type: none"> a. Any person who has been finally convicted by a competent judicial or administrative body of the 	<p>1. This Rule shall apply to companies mentioned under Sec. 38 of the Code and to companies with secondary licenses that adopted in their Manuals on Corporate Governance the practice of nominating and electing independent director/s in their Boards. Said entities shall be referred to in this Rule as “covered companies”.</p> <p>2. As used in Section 38 of the Code, independent director means a person who, apart from his fees and shareholdings, is independent of management and free from any business or other relationship which could, or could reasonably be perceived to, materially interfere with his exercise of independent judgment in carrying out his responsibilities as a director in any covered company and includes, among others, any person who:</p> <ul style="list-style-type: none"> A. Is not a director or officer of the covered company or of its related companies or any of its substantial shareholders except when the same shall be an independent director of any of the foregoing; B. Does not own more than two percent (2%) of the shares of the covered company and/or its related companies or any of its substantial shareholders; C. Is not related to any director, officer or substantial shareholder of the covered company, any of its related companies or any of its substantial shareholders. For this purpose, relatives include spouse, parent, child, brother, sister, and the spouse of such

¹³⁷ Source http://www.sec.gov.ph/notices/draft/code_corporate_governance-ii.htm accessed 18 September 2009

¹³⁸ SEC (2004) Amended Implementing Rules and Regulations of the Securities Regulation Code, February 13
<http://www.sec.gov.ph/irr/AmendedIRRfinalversion.pdf> accessed 18 September 2009

<p>following: (i) any crime involving the purchase or sale of securities, e.g., proprietary or non-proprietary membership certificate, commodity futures contract, or interest in a common trust fund, pre-need plan, pension plan or life plan; (ii) any crime arising out of the person's conduct as an underwriter, broker, dealer, investment company, investment adviser, principal distributor, mutual fund dealer, futures commission merchant, commodity trading advisor, floor broker; and (iii) any crime arising out of his relationship with a bank, quasi-bank, trust company, investment house or as an affiliated person of any of them.</p> <p>b. Any person who, by reason of any misconduct, after hearing or trial, is permanently or temporarily enjoined by order, judgment or decree of the Commission or any court or other administrative body of competent jurisdiction from: (i) acting as an underwriter, broker, dealer, investment adviser, principal distributor, mutual fund dealer, futures commission merchant, commodity trading advisor, or a floor broker; (ii) acting as a director or officer of a bank, quasi-bank, trust company, investment house, investment company or an affiliated person of any of them; (iii) engaging in or continuing any conduct or practice in connection with any such activity or willfully violating laws governing securities, and banking activities. Such disqualification shall also apply when such person is currently subject to an effective order of the Commission or any court or other administrative body refusing, revoking or suspending</p>	<p>child, brother or sister;</p> <p>D. Is not acting as a nominee or representative of any director or substantial shareholder of the covered company, and/or any of its related companies and/or any of its substantial shareholders, pursuant to a Deed of Trust or under any contract or arrangement;</p> <p>E. Has not been employed in any executive capacity by the covered company, any of its related companies and/or by any of its substantial shareholders within the last five (5) years;</p> <p>F. Is not retained, either personally or through his firm or any similar entity, as professional adviser, by that covered company, any of its related companies and/or any of its substantial shareholders, within the last five (5) years; or</p> <p>G. Has not engaged and does not engage in any transaction with the covered company and/or with any of its related companies and/or with any of its substantial shareholders, whether by himself and/or with other persons and/or through a firm of which he is a partner and/or a company of which he is a director or substantial shareholder, other than transactions which are conducted at arms length and are immaterial.</p> <p>3. No person convicted by final judgment of an offense punishable by imprisonment for a period exceeding six (6) years, or a violation of this Code, committed within five (5) years prior to the date of his election, shall qualify as an independent director. This is without prejudice to other disqualifications which the covered company's Manual on Corporate Governance provides.</p> <p>4. Any controversy or issue arising from the selection, nomination or election of independent directors shall be resolved by the Commission by appointing independent directors from the list of nominees submitted by the stockholders.</p> <p>5. When used in relation to a company subject to the requirements of this Rule and Section 38 of the Code:</p> <p>A. Related company means another company which is: (a) its holding company; (b) its subsidiary; or (c) a subsidiary of its holding company; and B. Substantial shareholder means any person who is directly or indirectly the beneficial owner of more than ten percent (10%) of any class of its equity security.</p>
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any registration, license or permit issued under the Corporation Code, Securities Regulation Code, or any other law administered by the Commission or Bangko Sentral ng Pilipinas, or under any rule or regulation promulgated by the Commission or Bangko Sentral ng Pilipinas, or otherwise restrained to engage in any activity involving securities and banking. Such person is also disqualified when he is currently subject to an effective order of a self-regulatory organisation suspending or expelling him from membership or participation or from associating with a member or participant of the organisation.

c. Any person finally convicted judicially or administratively of an offense involving moral turpitude, fraud, embezzlement, theft, *estafa*, counterfeiting, misappropriation, forgery, bribery, false oath, perjury or other fraudulent act or transgressions.

d. Any person finally found by the Commission or a court or other administrative body to have willfully violated, or willfully aided, abetted, counseled, induced or procured the violation of, any provision of the Securities Regulation Code, the Corporation Code, or any other law administered by the Commission or Bangko Sentral ng Pilipinas, or any rule, regulation or order of the Commission or Bangko Sentral ng Pilipinas, or who has filed a materially false or misleading application, report or registration statement required by the Commission, or any rule, regulation or order of the Commission.

e. Any person judicially declared to be insolvent.

6. Qualifications and Disqualifications

A. An independent director shall have the following qualifications:

- (xi) He shall have at least one (1) share of stock of the corporation;
- (xii) He shall be at least a college graduate or he shall have been engaged or exposed to the business of the corporation for at least five (5) years;
- (xiii) He shall possess integrity/probity; and
- (xiv) He shall be assiduous.

B. No person enumerated under Section II (5) of the Code of Corporate Governance shall qualify as an independent director. He shall likewise be disqualified during his tenure under the following instances or causes:

- (i) He becomes an officer or employee of the corporation where he is such member of the board of directors/trustees, or becomes any of the persons enumerated under Section II (5) of the Code on Corporate Governance;
- (ii) His beneficial security ownership exceeds two percent (2%) of the outstanding capital stock of the company where he is such director;
- (iii) Fails, without any justifiable cause, to attend at least 50% of the total number of Board meetings during his incumbency unless such absences are due to grave illness or death of an immediate family.
- (iv) Such other disqualifications which the covered company's Manual on Corporate Governance provides.

8. Nomination and Election of Independent Director/s

The following rules shall be applicable to all covered companies:

A. The Nomination Committee (the "Committee") shall have at least three (3) members, one of whom is an independent director. It shall promulgate the guidelines or criteria to govern the conduct of the nomination. The same shall be properly disclosed in the company's information or proxy statement or such other reports required to be submitted to the Commission.

B. Nomination of independent director/s shall be conducted by the Committee prior to

<p>f. Any person finally found guilty by a foreign court or equivalent financial regulatory authority of acts, violations or misconduct similar to any of the acts, violations or misconduct listed in paragraphs (a) to (e) hereof.</p> <p>g. Any affiliated person who is ineligible, by reason of paragraphs (a) to (e) hereof to serve or act in the capacities listed in those paragraphs.</p> <p>h. Conviction by final judgment of an offense punishable by imprisonment for a period exceeding six (6) years, or a violation of the Corporation Code, committed within five (5) years prior to the date of his election or appointment.</p> <p>The Board may also provide for the temporary disqualification of a director for the following reasons:</p> <p>a. Refusal to fully disclose the extent of his business interest as required under the Securities Regulation Code and its Implementing Rules and Regulations. This disqualification shall be in effect as long as his refusal persists.</p> <p>b. Absence or non-participation for whatever reason/s for more than fifty percent (50%) of all meetings, both regular and special, of the Board of directors during his incumbency, or any twelve (12) month period during said incumbency. This disqualification applies for purposes of the succeeding election.</p> <p>c. Dismissal/termination from directorship in another listed corporation for cause. This disqualification shall be in effect until he has cleared himself of any</p>	<p>a stockholders' meeting. All recommendations shall be signed by the nominating stockholders together with the acceptance and conformity by the would-be nominees.</p> <p>C. The Committee shall pre-screen the qualifications and prepare a final list of all candidates and put in place screening policies and parameters to enable it to effectively review the qualifications of the nominees for independent director/s.</p> <p>D. After the nomination, the Committee shall prepare a Final List of Candidates which shall contain all the information about all the nominees for independent directors, as required under Part IV(A) and (C) of Annex "C" of SRC Rule 12, which list, shall be made available to the Commission and to all stockholders through the filing and distribution of the Information Statement, in accordance with SRC Rule 20, or in such other reports the company is required to submit to the Commission. The name of the person or group of persons who recommended the nomination of the independent director shall be identified in such report including any relationship with the nominee.</p> <p>E. Only nominees whose names appear on the Final List of Candidates shall be eligible for election as Independent Director/s. No other nominations shall be entertained after the Final List of Candidates shall have been prepared. No further nominations shall be entertained or allowed on the floor during the actual annual stockholders'/memberships' meeting.</p> <p>F. Election of Independent Director/s</p> <p>i. Except as those required under this Rule and subject to pertinent existing laws, rules and regulations of the Commission, the conduct of the election of independent director/s shall be made in accordance with the standard election procedures of the company or its by-laws.</p> <p>ii. It shall be the responsibility of the Chairman of the Meeting to inform all stockholders in attendance of the mandatory requirement of electing independent director/s. He shall ensure that an independent director/s are elected during the stockholders' meeting.</p> <p>iii. Specific slot/s for independent directors shall not be filled-up by unqualified nominees.</p> <p>iv. In case of failure of election for independent director/s, the Chairman of the Meeting</p>
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<p>involvement in the alleged irregularity.</p> <p>d. Being under preventive suspension by the corporation.</p> <p>e. If the independent director becomes an officer or employee of the same corporation he shall be automatically disqualified from being an independent director.</p> <p>f. If the beneficial security ownership of an independent director in the company or in its related companies shall exceed the 10% limit.</p> <p>g. Conviction that has not yet become final referred to in the grounds for the disqualification of directors.</p>	<p>shall call a separate election during the same meeting to fill up the vacancy.</p> <p>v. The covered companies shall amend its by-laws in accordance with the foregoing requirements as soon as practicable.</p> <p>9. Termination/Cessation of Independent Directorship</p> <p>In case of resignation, disqualification or cessation of independent directorship and only after notice has been made with the Commission within five (5) days from such resignation, disqualification or cessation, the vacancy shall be filled by the vote of at least a majority of the remaining directors, if still constituting a quorum, upon the nomination of the Committee otherwise, said vacancies shall be filled by the stockholders in a regular or special meeting called for that purpose. An independent director so elected to fill a vacancy shall serve only for the unexpired term of his predecessor in office.</p>
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APPENDIX 6: COMPARISON OF MANDATED FINANCIAL INSTRUMENTS, INVESTMENT FUNDS AND CEILINGS BETWEEN SSS AND GSIS

Financial Instrument	SSS ¹³⁹ Sub-Section of Section 26 ¹⁴⁰ Investment Reserve Fund	SSS Ceiling	GSIS Sub-Section of Section 36 ¹⁴¹ Investment of Funds
Government Instruments	a) In bonds, securities, promissory notes or other evidence of indebtedness of the Government of the Philippines, or in bonds, securities, promissory notes or other evidence of indebtedness to which the full faith, credit and unconditional guarantee of the Government of the Philippines is pledged.	-	a) In interest-bearing bonds or other evidence of indebtedness of the Government of the Philippines;
Domestic infrastructure	b) In bonds, securities, promissory notes or other evidence of indebtedness of the Government of the Philippines or any of its agencies or instrumentalities to finance domestic infrastructure projects such as roads, bridges, ports, telecommunications and other similar projects; Provided that the instruments issued by an agency or instrumentality of the government shall be guaranteed by the Government of the Philippines or any government financial institution or acceptable multilateral agency; provided further the SSS shall	30%	-

¹³⁹ Adapted from Social Security Act of 1997/Republic Act 8282 (2006)

¹⁴⁰ Section 26 of the SSS Act states: “No portion of the Investment Reserve Fund or income thereof shall accrue to the general fund of the National Government or any of its agencies or instrumentalities, including government-owned or controlled corporations, except as may be allowed under this Act.”

¹⁴¹ Section 36 Investment of Funds of GSIS Act: “The funds of the GSIS are which are not needed to meet the current obligations may be invested under such terms and conditions and rules and regulations as may be prescribed by the Board; Provided, that investment shall satisfy the requirements of liquidity, safety/security and yield in order to ensure the actuarial solvency of the funds of GSIS; Provided, further, that the GSIS shall submit an annual reports on all investments made to both Houses of Congress of the Philippines to wit:”

	have priority over the revenues of the projects; provided that such investments shall not exceed 30% of the Investment Reserve Fund		
Government financial institutions and corporations	c)	In bonds, securities, promissory notes or other evidence of indebtedness of the government financial institutions or government corporations with acceptable credit or guarantee; provided that such investments shall not exceed 30% of the Investment Reserve Fund	30%
Banks	d)	In bonds, securities, promissory notes or other evidence of indebtedness of any bank doing business in the Philippines and in good standing with the BSP to finance loans to private corporations doing business in the Philippines including schools, hospitals, small and medium scale industries, cooperatives and NGOs; in which case the collaterals or securities shall be assigned to the SSS, under such terms and conditions as the commission may prescribe: provided that in the case of bank deposits, they shall not exceed at any time the unimpaired capital and surplus or total private deposits of the depository bank, whichever is smaller; provided further that said bank shall first have been designated as a depository for this purpose by the Monetary Board of the BSP; provided that such investments shall not exceed 40% of the Investment Reserve Fund	40%
	b)	In interest-bearing deposits or securities in any domestic bank doing business in the Philippines; Provided: that in the case of such deposits, these shall not exceed at any time the unimpaired capital and surplus or total deposits of the depository bank whichever is smaller: Provided further; that said bank has prior designation as a depository for the purpose by the Monetary Board of the Central Monetary Authority	
Housing; Loans to Members	e)	In bonds, securities, promissory notes or other evidence of indebtedness of shelter agencies of the national Government or financial intermediaries to finance housing loans of members; and in long-term direct individual or group housing loans giving priority to the low-income groups, up to a maximum of 90% of the appraised value of the properties to be mortgaged by the borrowers; and in short and medium	35%; 10%
	c)	In direct housing loans to members and group housing projects secured by first mortgage, giving priority to the low income groups, and in short- and medium-term loans to members such as salary, policy, educational, emergency, stock purchase plan, and	

	term loans to members such salary, educational, livelihood, marital, calamity and emergency loans; Provided that not more than 35% of the Investment Reserve Fund at any time shall be invested for housing purposes: provided further that no more than 10% of the Investment Reserve Fund shall be invested in short and medium term loans”		other similar loans; Provided that no less than 40% of the investable fund of the GSIS Social Insurance Fund shall be invested for these purposes. Ceiling of 40%
Education and Medical Institutions	f) In bonds, securities, promissory notes or other evidence of indebtedness of educational or medical institutions to finance the construction, improvement and maintenance of schools and hospitals and their equipment and facilities: provided that such investments shall not exceed 10% of the Investment Reserve Fund	10%	d) In bonds, securities, promissory notes or other evidence of indebtedness of educational or medical institutions to finance the construction, improvement and maintenance of schools and hospitals
Real Estate	g) In real estate property, including shares of stocks involving real estate property, and investments secured by first mortgages on real estate or other collaterals acceptable to the SSS: provided that such projects and investments shall in the determination of the Commission, redound to the benefit of the SSS, its members as well as the general public: provided further, that investment in real estate property including shares of stocks involving real estate property shall not exceed 5% of the Investment Reserve Fund: provided finally, that investments in other income-earning projects and investments secured by first mortgages or other collaterals shall not exceed 25% of the Investment Reserve Fund	30%	e) In real estate property including shares of stocks involving real estate property and investments secured by first mortgages on real estate or other collaterals acceptable to GSIS: Provided, that such investments shall, in the determination of the Board, redound to the benefit of the GSIS, its members as well as the general public
Projects involving prime corporations or multilateral	h) In bonds, securities, promissory notes or other evidence of indebtedness of any prime corporation or multilateral institution to finance domestic projects: provided that the issuing or assuming entity or its predecessors shall not have defaulted in the payment of interest on any of its securities and that during each of any 3 including the last of the 5 fiscal	30%	-

institutions	years next preceding the date of acquisition by the SSS of such bonds, debentures or other evidence of indebtedness, the net earnings of the issuing or assuming institution available for its fixed charges, as defined in this Act, shall have been not less than 1 and ¼ times the total of fixed charges for such ear: provided further that such investments shall not exceed 30% of the Investment Reserve Fund			
Domestic Capital Market Investments	i)	In preferred or common shares of stocks listed or about to be listed in the stock exchange or options or warrants to such stocks, or subject to prior approval of the BSP, such other risk management instruments of any prime or solvent corporation or financial institution created or existing under the laws of the Philippines with proven track record of profitability over the last 3 years and payment of dividends at least once over the same period. Provided that such investments shall not exceed 30% of the Investment Reserve Fund.	30%	f) In debt instruments and other securities traded in the secondary market; g) In loans to, or in bonds, debentures, promissory notes or other evidence of indebtedness of any solvent corporation created or existing under the laws of the Philippines h) In common and preferred stocks of any solvent corporation or financial institution created or existing under the laws of the Philippines listed in the stock exchange with a proven track record of profitability over the last 3 years and payment of dividends at least once over the same period;
Domestic (and Foreign Mutual Funds)	j)	In domestic or foreign mutual funds in existence for at least 3 years: provided that such investments shall not exceed 20% of the Investment Reserve Fund: provided further that investments in foreign mutual funds shall not exceed 1% of the Investment Reserve Fund in the first year which shall be increased by 1% for each succeeding year but in no case shall it exceed 7.5% of the Investment Reserve Fund	20% (7.5%)	i) In domestic mutual funds including investments related to the operations of mutual funds

Foreign Currency Instruments	k) In foreign currency deposits or triple A foreign currency denominated debts, prime and non-speculative equities, and other BSP approved financial instruments or other assets issued in accordance with existing laws of the countries where such financial instruments are issued. Provided that these instruments or assets are listed in bourses of the respective countries where the instruments or assets are issued. Provided further that the issuing company has proven track record of profitability over the last 3 years and a record of regular dividend payout over the same period. Provided finally that such investments shall not exceed 1% of the Investment Reserve Fund in the first year which shall be increased by 1% for each succeeding year, but in no case shall it exceed 7.5% of the Investment Reserve Fund.	7.5%	j) In foreign mutual funds and in foreign currency deposits or foreign currency-denominated debts, non-speculative equities and other financial instruments or other assets issued in accordance with existing laws of the countries where such financial instruments are issued: Provided; that these instruments or assets are listed in bourses of the respective countries where these instruments or assets are issued: Provided further, that the issuing company has a proven track record of profitability over the last three (3) years and payments of dividends at least once over the same period.
Secured Loans	l) In loans secured by such collaterals like cash, government securities or guarantees of multilateral institutions. Provided that such investments shall not exceed 30% of the Investment Reserve Fund	30%	
Other BSP-approved Investment Instruments	m) In other BSP approved investment instruments with the same intrinsic quality as those enumerated in paragraphs a) to l) hereof, subject to the policies and guidelines which the commission may formulate.	-	

APPENDIX 7: PROPOSAL QUESTIONNAIRE AND PROPOSAL EVALUATION MATRIX FOR GSIS' GLOBAL FUND MANAGER

Table A7.1: GSIS Global Fund Manager (GFM) – Abridged Version of the Proposal Questionnaire and Evaluation Criteria¹⁴²

Proposed Investment Strategy	<p>1. What is your proposed asset allocation? Discuss the portfolio allocation in terms of asset class, region, sector, and currency that would meet the GSIS return objective indicated in this RFP.</p> <p>2. Explain how asset allocation decisions will be taken. How do you propose to implement the absolute-return strategy for the GSIS?</p> <p>3. Provide an estimate of the expected return and expected volatility of your proposed portfolio. Describe the best and the worst case scenario for the strategy you suggest to implement.</p>
Historical Performance	<p>1. Indicate the years of experience of the individual members of your investment team:</p> <p>1.1 in fund management; and</p> <p>1.2 in managing absolute return portfolio (in particular).</p> <p>7. State whether your company has been affected by the recent sub-prime crisis? If yes, please state the extent of your exposure (in absolute amount) and its relation in percentage terms with this asset class.</p>
Risk Management	<p>1. Describe your firm's philosophy and risk management framework.</p> <p>2. Describe your firm's risk management policies and controls with regard to the management of third party assets under management.</p> <p>3. Is your risk management process, including compliance monitoring and investment procedures created for clients' portfolio, subject to periodic review of an independent third party? If yes, please explain.</p> <p>4. What were the actions instituted to reduce the negative effects of global economic events such as the recent sub-prime crisis and weakening of the US\$?</p> <p>5. What are the risk reports provided to clients? What is the frequency of such reporting?</p> <p>6. What risk measures do you use to track and control downside risk?</p> <p>7. What are the market conditions that would favor your suggested approach to the absolute-return strategy and what</p>

¹⁴² Excludes the Reporting and Training Criteria; From GSIS (2008c)

	<p>conditions would be detrimental to it?</p> <p>8. From among your independent risk division or Risk Oversight Committee, please provide the curriculum vitae (Attachment 9) of at least three (3) risk management officers.</p>
Organisation	<ol style="list-style-type: none"> 1. Describe your firm's ownership structure and provide an organisational chart (please include a diagram of ownership structure). Identify affiliated or subsidiary organisation(s). 2. Describe the firm's management and organisational structures (please include a diagram of management and organisational structures). Where are investment management operations located and which location would be responsible for the proposed mandate? 3. Who regulates the firm in the course of its investment management business? 4. Describe any restructuring or organisational changes that have occurred within the firm over the past three years. Discuss any planned organisational changes that could be implemented in the near future. 5. Explain any legal judgments or proceedings associated with your firm or any officer or principal within the last three years. Specify whether your firm is involved in any pending litigation or investigations. 6. If there are any SEC actions, state regulatory actions, professional organisation or other actions against your organisation, any owners, principals, or other personnel, describe them in detail. 7. What is the extent of your Errors and Omissions cover or similar insurance cover, if any? Provide confirmation of cover, amounts, the insurer and details of any claims in the last three years.
Investment Philosophy and Style	<ol style="list-style-type: none"> 1. Describe your investment philosophy, strategy, discipline and investment style. 2. Describe your investment process and the responsibilities of the different units in your organisation. 3. Describe the investment decision making and portfolio construction processes for this mandate. What are your criteria in selecting potential investments? 4. What quantitative model(s) do you use in your process and indicate whether it is proprietary or not? 5. Describe how both internal and external research is utilized and incorporated in the portfolio. Please indicate sources of external information. 6. What is the percentage contribution to decision making of quantitative (fundamental and technical) and qualitative (judgmental and behavioral) methods of analysis?

Table A7.2: GSIS' GFM Proposal Evaluation Matrix

Parameters	Maximum Points
A. Proposed Investment Strategy	30%
B. Historical Performance	25%
C. Risk Management	20%
D. Organisation	15%
E. Reporting	5%
F. Training	5%
TOTAL	100%

APPENDIX 8: LIST OF CORPORATE GOVERNANCE NODES IN NVIVO

Node	Sources	References
Corporate governance - accountability	25	34
Corporate governance - accreditation	5	6
Corporate governance - advantages of	22	36
Corporate governance - advocates of, champions of, promoters of	31	73
Corporate governance - American influence and practices	9	15
Corporate governance - applicability of	43	109
Corporate governance - Australian influence	15	35
Corporate governance - awareness	48	145
Corporate governance - behaviour	33	65
Corporate governance - better practices ; exemplars	23	52
Corporate governance - capacity - lack of	11	18
Corporate governance - capital markets - link with	22	64
Corporate governance - challenges	33	74
Corporate governance - competitive advantage	16	35
Corporate governance - control system	20	30
Corporate governance - cost of	7	10
Corporate governance - demands	26	51
Corporate governance - disclosure	36	95
Corporate governance - disclosure - information asymmetry	8	11
Corporate governance - disincentives	14	15
Corporate governance - documents	7	8
Corporate governance - documents - BSP CG manual	4	10
Corporate governance - documents - CG charter	2	3
Corporate governance - documents - code of conduct	6	10
Corporate governance - documents - code of corporate governance	3	6
Corporate governance - documents - code of ethics	4	7
Corporate governance - documents - SEC CG Manual	9	12
Corporate governance - drivers of	33	69
Corporate governance - effect on SMEs	10	22
Corporate governance - enforcement	18	38
Corporate governance - executive compensation	4	4
Corporate governance - external cooperation pressures	10	14
Corporate governance - fairness	3	4
Corporate governance - form and substance	11	19
Corporate governance - formalisation	27	53
Corporate governance - future of	18	28
Corporate governance - harmonisation internationalisation globalisation of	19	36
Corporate governance - impact of	9	18

Corporate governance - implementation of	30	72
Corporate governance - improving improvements	31	62
Corporate governance - invoking for propaganda	4	5
Corporate governance - limitations of	10	15
Corporate governance - operationalising	34	77
Corporate governance - organisations international etc	4	12
Corporate governance - origins in the Philippines introducing	13	18
Corporate governance - perception	38	100
Corporate governance - performance	6	11
Corporate governance - portability or transferability	10	18
Corporate governance - principles of	17	34
Corporate governance - professionalism	26	51
Corporate governance - promotion in the Philippines	30	73
Corporate governance - promotion to suppliers	2	2
Corporate governance - qualitative assessment intangible perception	5	10
Corporate governance - quality of	14	17
Corporate governance - recognition - lack of or reward	12	17
Corporate governance - regulators	38	100
Corporate governance - regulators - Financial Sector Forum	6	8
Corporate governance - regulatory cooperation	6	7
Corporate governance - relationship based	16	19
Corporate governance - reporting	25	45
Corporate governance - ripple effect of	11	15
Corporate governance - risk management	21	43
Corporate governance - rules based	5	5
Corporate governance - succession planning	18	36
Corporate governance - tiered view segregated	4	7
Corporate governance - transparency	38	87
Corporate governance - value of	30	54
Corporate governance - weakness of	15	20
Corporate governance as a tool - misuse of	6	6
Corporate governance as a trend	11	17
Corporate governance as business sense	32	58
Corporate governance as compliance	37	95
Corporate governance as leverage	14	21
Corporate governance as practice pragmatism	40	98
Corporate governance as protection or improving reputation	15	25
Corporate governance data - dearth or paucity	2	2
Corporate governance practice as attracting investment	29	57
Corporate governance ranking	5	10
Corporate governance reforms	36	102
Corporate governance scorecard	5	11
Corporate governance standards checklist	26	48

APPENDIX 9: LIST OF CORRUPTION NODES IN NVIVO

Node	Sources	References
Corruption	37	68
Corruption - addressing or countering	20	46
Corruption - arrangements for activities	8	10
Corruption - arrangements for activities - overseas	4	4
Corruption - bribery	7	11
Corruption - cheating	6	7
Corruption - corruptor - corruptee	6	7
Corruption - culture of	10	12
Corruption - East Asia outside Philippines	10	16
Corruption - effects on country	19	33
Corruption - effects on personnel	12	18
Corruption - effects on SMEs	2	3
Corruption - embezzlement	6	6
Corruption - endemic entrenched	9	13
Corruption - extortion	3	7
Corruption - favouritism or reciprocity	13	16
Corruption - feeling towards	22	53
Corruption - fraud - Ponzi schemes pyramid investment scams	8	12
Corruption - gifts	4	4
Corruption - graft	10	27
Corruption - influence peddling	9	14
Corruption - institutionalised organised centralised	12	21
Corruption - kickbacks	2	4
Corruption - long term	8	8
Corruption - major	7	8
Corruption - petty	4	5
Corruption - pork barrelling	2	2
Corruption - presence with servicing the public discretionary	8	11
Corruption - presidential	16	22
Corruption - private sector role	11	14
Corruption - rent-seeking ; short-term	17	32
Corruption - smuggling	2	2
Corruption - soft and hard	2	2
Corruption - theft	5	6
Corruption - theory theoretical	1	2
Corruption - undue influence	5	7
Corruption - unpredictability	8	12
Foreign ownership controls - facilitating corruption	2	2

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